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The Auditor

PUBLISHED IN THE INTEREST OF THE PROFESSIONAL ACCOUNTANT.

Vol. I.

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No. 1.

THE AUDITOR

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SALUTATORY.

THE AUDITOR makes its appearance in response to a feeling on the part of the members of the Illinois Society of Certified Public Accountants, that the profession needs the means of communication afforded by an organ under its own control.

Until now the accounting profession in America has had no organ devoted solely to its interests, but has been obliged to content itself with a corner in publications representing other lines.

Within the last ten years the accounting profession in America has accomplished more in establishing its usefulness in the opinion of the business community than had been accomplished in all the decades preceding. The growth of the public accounting field has been so considerable that numerous state societies and associations have been formed to further the interests held in common by their members. One of these organizations is the Illinois Society of Certified Public Accountants, and one means it proposes to take to benefit the profession is to establish and publish this paper.

While the primary object of the publication has been to forward the interests of the Illinois society, it is hoped that at the same time the accounting profession of the whole country may be substantially benefited. An important mission of this paper is to carry to business houses not yet cognizant of the value of the services of a public accountant full information on that subject, and in that way help to increase the clientage of the members of the profession. In so doing it believes that it will be serving both parties beneficially and will prove the wisdom of the steps taken to establish it.

THE AUDITOR will be the organ of no faction, nor will it serve the interests of individuals any way other than through its work in the profession at large. It is hoped that as time goes on this paper may increase in usefulness, and to that end it will welcome the co-operation of all who are interested in the accounting profession.

The publication is itself the outgrowth of combined effort, and has strong faith in the efficiency of concentrated forces working to a common end.

It believes that the field for the work of the accountant can be made wide enough to hold all the capable workers, and that there is no reason why any member of the profession should hesitate to join hands

with his fellows in the effort in aid of which it has come into being.

It is hoped this paper may materially assist in securing for the accounting profession, from the general public, the same degree of respect and consideration as is accorded to other learned professions. We believe that no other profession affords more room for the exercise of strong mental effort, nor requires more careful training for the proper discharge of its functions, and it shall be the constant effort of THE AUDITOR to demonstrate to the business public that our opinion of the profession has been correctly formed.

We have no elaborate promises to make, nor do we assume that the world has been waiting for us. We do, however, assure our readers and supporters that we will spare no effort to supply them with the best we can possibly produce, and to that end we ask their friendly co-operation.

The law authorizing the University of Illinois to confer the degree of certified public accountant upon candidates whose fitness is established, has been in force for over a year, but the examiners have not been able to dispose of more than half the applications filed.

There is a disposition in some quarters to criticize the Board of Examiners for what seems to be an excess of deliberation. While the amount of time taken by the board does seem plenty, we presume no one will seriously object if it develops that the delay has been occasioned by an abundance of caution in passing on the qualifications of candidates.

If the degree is to be that valuable testimonial of professional fitness and good character which the law intends it shall be the board can hardly be too cautious in making its recommendations to the university. While the board has expressed no desire for sympathy, it is undoubtedly entitled to much consideration. Its task is by no means a pleasant one, and is accomplished only by a considerable sacrifice of time on the part of the examiners, and the assumption by them of thankless responsibilities. The board may make mistakes—possibly has made mistakes—but that it has acted only with the best of motives no one can safely gainsay.

The accounting profession in Illinois owes a substantial debt of gratitude to the Board of Examiners, and should not be slow in acknowledging it.

Speaking of the C. P. A. law and its administration, brings to mind the great University of Illinois, and recalls the fact that it is not very long ago that accountants had practically no interest in the university and the university only a hazy conception of the part played by the accountant in the business affairs of the world. Both parties are better acquainted now, and it is to be hoped that the acquaintance may not be permitted to lapse. It is distinctly beneficial to the accountant to feel that he is connected with a great institution of learning, which will take pride in his successes, and be glad to be to him an alma mater, if he be to it a loyal son.

On the other hand, the university will benefit from the contact, for the accountant supplies a needed link between the "cold culture" of the university and the "shirt sleeves" of practical affairs. Our colleges have long needed to be drawn away from their tendency to deal chiefly with the theoretical and the ideal, and be brought closer to the practical, everyday affairs of life. The introduction of engineering courses, with their necessary workshops, did much to give the practical side of life a standing with the universities, and it may be expected their courses in commerce and accounts will further this good work. In time the accountants may secure their "Juniors" from the "Rah-Rah Boys," and the universities their lecturers on commercial subjects from the ranks of the public accountants—and both parties get the best.

The Congress of Accountants, to be held at St. Louis during the last week in September, which, from all reports, bids fair to be a large and representative gathering, will serve to call attention to the growth of the profession in the United States, as well as to confer many direct benefits on the participants.

Such a gathering at the World's Fair of 1893 in Chicago could not have been brought about. There were comparatively few accountants in this country at that time and they were largely occupied with local business. There were few, if any, organizations of accountants, whereas there are now many state societies, not to speak of the national organization known as the Federation. Nothing could be more beneficial than these societies, which afford an opportunity for acquaintance among the members of the profession not otherwise obtainable.

Somebody has said that "every really expert accountant is thoroughly conceited." If this be true, there can be no better way to reduce this conceit than by bringing the accountants together and permitting them,

through acquaintance, to learn that the "other fellow" is possibly as well up in his calling and as much entitled to the respect of the business community as he who has regarded himself the best going. The fact is that to establish one's self successfully in the accounting business there is required a very considerable amount of ability, and it is safe to assume that anyone securely established in the profession will, upon acquaintance, prove to be well toward the top in the matter of mental equipment.

The program of the congress, as it comes to hand, promises a valuable contribution to the literature of the profession, as well as a thoroughly entertaining arrangement of the events of the session. It is a rare piece of good fortune that the great Pixley is to be there, and he no doubt will be gratified to learn that his American cousins are as much determined to raise the profession to the highest plane in this country as he has been to keep it there, in Britain.

The time is coming in this country when the courts will cease appointing as receivers of estates in liquidation, the political hacks and chronic hangers-on, who have heretofore so frequently been chosen for these responsible positions. The results of some of these appointments have been positively disgraceful, while in the vast majority of cases the result has been anything but creditable. The responsibility for these unfortunate appointments rests primarily upon the courts, though in many instances this responsibility is shared by the attorneys who agree upon some "good fellow" for the place, without thought as to his qualifications. There are three classes of men who are really qualified to fill the position of a receiver. One class is composed of business men who are too much occupied with their private affairs to give the receivership proper attention. Another class is composed of competent men, who are out of business or out of employment, and

are exceedingly scarce, because most business men who are competent are either in business on their own account or employed by others. The third class is composed of public accountants. These men are peculiarly well fitted for these positions by reason of their varied experience in all lines of business. They know what to do. Where one is appointed receiver he knows how to take charge of the estate and knows enough to at once make an inventory of what has come into his hands and to promptly submit such inventory to him. He knows how as they are liquidated report his acts and doings to the court. In the event that he is given authority to carry

on the business of the estate in his charge, he is competent to know quickly whether that can be done with economy or otherwise.

In short, his training fits him, as no other man is fitted, to perform the functions of a receiver. Aside from his general fitness for the actual work of the position, there is to be considered his availability. His business is of a character that leaves him at all times free to take up whatever may come along. His work is a succession of short engagements, and he is trained in the art of quickly adapting himself to a new environment.

It is not unusual for a public accountant to be deep in the investigation of three totally different lines of business within one week, as, for instance, a brewery, a millinery establishment and a charitable organization. One of our courts has within a recent period of time appointed two public accountants to important receiverships. One of these has been closed and the receiver discharged. The court files nowhere disclose as prompt handling of a large estate, nor as complete and lucid reports as in this case. In the other case the appointment is quite recent, but the good record made in the first instance will be fully equaled.

Just as soon as lawyers and courts awaken to the fact that receiverships deserve the attention of the best talent obtainable, and that the interests of all parties demand a prompt, clean and business-like administration of affairs, the old practice of appointing ward heelers, or prominent business men who have not time to give to it beyond drawing their fees, there will be a turning to the public accountant as the most available and best-fitted man in the business community for such positions, and the result will not be disappointing.

The Illinois Society of Certified Public Accountants is now completely organized. Its directors and officers are giving careful consideration to plans calculated to benefit the membership.

The organization which the society succeeds (the Illinois Association of Public Accountants) for six years labored hard in behalf of the law providing for the certification of public accountants, and had the satisfaction, at last, of seeing its efforts crowned with success. Then, feeling that a new organization was necessary to carry on the work, it brought into being, as its successor, the present society. Membership in the society is conditioned strictly upon the applicant being a C. P. A., and, in addition, of good character.

It is hoped that every accountant holding a certificate granted by the University of Illinois may become a member.

In another column will be found a contribution on the question of the propriety and desirability of an accountant advertising his business. Strangely enough, the contributor is not an accountant of wholly American training. He was articleed and served his time with a firm of English accountants in dear old London before his feet touched the soil of Yankee land, where the advertiser blooms as in no other clime. If he brought with him any prejudice against the practice of advertising by accountants, he seems to have gotten well rid of it. The subject has two sides to it, and in our next issue we hope to have the other side presented by someone fully competent.

In passing it may be said that there can be little criticism on advertising kept within decent bounds. The fact must always be borne in mind that accountants are soliciting engagements of a confidential character, are asking to be admitted to the inner sanctum of the client's business affairs, and cannot expect the discriminating and desirable client to be dazzled by a flaring display of self-described accomplishments. On the other hand, there is no real good reason why an accountant should hide his light under a bushel. He should not expect a client to organize a searching party to find him. The proper thing to do would seem to be to advertise in a modest, dignified manner, giving all needed information as to location, telephone number and firm name. By this means one may become known to the public, and when called upon to convince the prospective client of his worth, may then very properly produce evidence which, if volunteered in an advertisement, would have seemed exceedingly inmodest, if not, indeed, vulgar.

The movement for the certification of accountants will result in making it less necessary to advertise in a commercial manner, as the possession of the C. P. A. degree will in itself be strong testimony of professional worth. It will take the place, to a large extent, of the references heretofore exacted, and, to more quickly bring this about, each certified public accountant should offer no further reference as to his professional fitness than his possession of the C. P. A. degree. Who thinks of asking a lawyer or physician to submit references as to his professional fitness? If he were not fit he could not be a lawyer or physician, and the public knows it. Now let the certified public accountant educate the public into an understanding that the C. P. A. couldn't be a C. P. A. if he were not fitted for the work by training and experience, nor if he were not of good personal character, and much of the present need of advertising will pass away.

THE MAN WITH ONE SYSTEM.

In the days of the old Greek mythology there flourished a man named Procrustes, who entertained travelers in his own peculiar way. If his guest was too short to fit the bed provided for him he was very strenuously stretched until sufficiently lengthened, while if his inches were overabundant he was relieved of a few of them by the summary process of chopping them off his legs. In this way Procrustes had the satisfaction of always having a bed to fit his guests, but no mention is made of the degree of satisfaction enjoyed by his victims.

In the course of time Procrustes seems to have been consigned to that limbo which the prayer book gently calls "the place of departed spirits." But his soul, like that of John Brown, is still marching on, and in these latter days it has been reincarnated in the man with a pet system. True to his prototype, this man, usually incorporated, who generally styles himself an expert accountant, has but one measure for all who are unfortunate enough to fall into his clutches. His system is the best for certain lines of business and therefore he argues it must be best for all. If the business does not fit very comfortably into all the angles of the system it must be pruned here and stretched there until to a certain extent it conforms to the hard and fast lines laid out for it. That there will be friction in all the future workings of the office machinery is not the fault of the system, but of the business for not being a better fit. The "expert" seldom cares anyway, for he has collected his fee and is off in search of further victims.

The reputable certified public accountant would naturally feel sorry to see anyone so victimized and would content himself with expressing that sorrow. But unfortunately the matter is much more far-reaching, for the victim and his friends do not discriminate between the so-called expert and the scientific accountant, nor realize that the latter would proceed in an entirely different way, to carefully study the needs of the business in question and then to devise out of his manifold experience and with the aid of his trained mind the best system for that particular business.

One of the objects of this journal will be to draw the line between the real and the pretended accountant and to educate the general public in a proper discrimination between them. Incidentally it may be that the successors of Procrustes may be shown that it is more scientific to fit the bed to the guest, and as for the latter that it is infinitely more comfortable and profitable for him to employ someone who knows how to do it, rather than allow himself to be stretched or curtailed to fit the bed.

SHOULD THE PROFESSIONAL ACCOUNTANT ADVERTISE?

BY HENRY MILLARD, C. P. A.

What most direct means are available to one who has something to sell to the public, whereby he may let it be known that he has anything valuable for sale? In the case of a merchant, does he depend upon his comparatively few friends to eulogize him and his goods to their acquaintances? He would starve were he to rely on so slender a chance. Although he may have served his friends well, he has received from them a fair equivalent and therefore has no right to expect that they will trouble themselves to advertise him. Most men are too absorbed in their own affairs to go out of their way to advance the interests of others. Possibly it was not so in former times, possibly it may not be so now in older countries, where courtesy and genuine friendliness characterize business relations, where people have no feverish desire to get rich quickly, where perhaps a mature wisdom realizes that it is not well to sacrifice noble thoughts and impulses in order to gratify a greedy avarice. It is said that we in the United States are worshipers of the almighty dollar and that all that is good in us, all human sympathy, is obliterated in our strivings to obtain it.

The merchant, knowing this condition, does not depend on his friends to say kind words for him. He finds that he must blow his own horn through the medium of advertisements. The professional accountant must do the same if he wishes to make a success of his practice. Many accountants say that it is unprofessional to advertise. I venture the opinion that a canvass of these men will disclose that they are British-born. It is true that advertising is unprofessional in England, but that is another country, one of those older countries to which I have alluded, where the relations between the accountant and his client are more firmly established than they are here. There the client has confidence in his accountant and does not regard him as a robber, whose object is to render as little service for as high a fee as possible. When he has once employed an accountant, the latter may generally regard him as a permanent addition to his clientele and can depend upon him to recommend him to his friends. In this country the client cannot be regarded as one who has come to stay. He cares little that when an audit or other contract is undertaken for a specified sum, the accountant frequently suffers considerable loss in the conscientious performance of work which may necessitate much more time than could have been foreseen in the usual cursory survey upon which the fee is based. When he needs an accountant again he may

instinctively call for the one he has already employed, but if he does, it will usually be in competition with bids asked for from others. The thoroughly professional character of the work previously done for him does not weigh so much as the hope of getting it done for a dollar or two less. Competition is a good thing in trade where the buyer is thoroughly conversant with the goods he is purchasing. When it comes to a question of professional services the ordinary man is not able to discriminate between the relative merits of applicants. He may claim to be a "bit of an expert" himself, when in reality he is not even a good bookkeeper, and until you have a chance to prove your superior worth he will judge your fee by comparison with what he pays his bookkeeper. Brains, ingenuity and integrity count for but little with him. He says the accountant who can do his work for the least money will get his orders, as if he were buying goods.

Under these circumstances the principal dependence must be on obtaining new clients by judicious advertising. Some of the mediums open to accountants are, the daily newspaper, the periodical financial or trade organ, circular letters, circular post-cards and special letters. The daily newspaper is little used except by bookkeepers, temporarily employed, who imagine that their limited experience is sufficient to enable them to understand the complexities of accounting that need the best thought of the trained and experienced accountant. The professional accountant does not care to use the want ad or even the accountants' column where these advertisements are usually found, because he does not wish to be classified with the man out of work nor with the self-styled expert whose service is generally cheap and incompetent. Were the newspapers to open a column classified as Certified Public Accountants it is probable that many of that class would use it and thereby a distinct gain would result through a wider recognition of accountancy as one of the learned professions. The ordinary advertisement, crowded in between those setting forth the merits of pills, soap and business chances, besides being hard to find, is not only expensive but worthless.

The circular letter is a good medium, though more expensive than those already mentioned. If sent with a penny stamp it impresses the recipient at once with the idea that it is a general circular, and it is frequently not opened at all. In many offices such matter is consigned to the waste basket without reaching any important person. If sent with letter postage, masquerading as a specially written letter, it may get through the picket lines and be opened, but unless the

appearance of it is such as to continue the deception, or unless attention is compelled by the opening lines, the chances are that the reader will cast it aside without finishing it.

The circular post-card, besides being less expensive than the sealed letter, has the further advantage of being more likely to be read, if not too apparently a circular, as it is usually shorter.

The special letter is undoubtedly the best medium, although the most expensive. Great ingenuity should be used in its wording in order to make the desired impression. The percentage of replies may be very small, but all who have taken the trouble to answer should be regularly followed up in order to deepen the impression already made. Follow up also those who have not replied in hopes of eventually awakening their interest.

Some accountants canvass business houses, without any preliminary introduction, but this is extremely undignified and tends to belittle the worth of those who do it. It is, however, a good plan to call after having written a few letters, as you have then been, in a sense, introduced, and the business man will greet you as if he knew you.

So much for advertising by the individual accountant. There has been some talk about collective advertising, by which is meant such publicity as could be given to the profession by the representative bodies of accountants throughout the country, but little or nothing has been done so far. Accountants have been associated together in their various societies for nearly ten years, and yet the average business man scarcely knows of the existence of the professional accountant as distinct from the bookkeeper or self-styled expert. In my opinion this is due to the fact that until recently there have been more Britons than native Americans practicing accountancy in this country, and that they have been unable to see that the conditions attendant on building up a practice here are different from those that prevail on the other side of the Atlantic. That the profession is now beginning to awaken to the need of advertising is due to the influx of continually increasing numbers of Americans. To them the Britons have taught their profession, and it remains for the natives to exploit that profession.

In the limited space available for this paper much that might be said in regard to collective advertising must be omitted or postponed to the future. There are many professional accountants who have given considerable thought to the subject, and it is to be hoped that we may shortly hear their views.

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THE NECESSITY FOR ACCURATE COST KEEPING.

At the present time there is no detail of his business so important to the Manufacturer as the cost of the various article manufactured. During the past few years money has been made with such comparative ease and rapidity that the Manufacturer has not had any occasion to ascertain how much the profit was on each particular article. It sufficed that at the close of each fiscal period the profit and loss account showed a good balance on the right side. In these days of keener competition and increased cost of materials and labor, followed by a corresponding decrease in the profits, the Manufacturer is compelled to closely examine the costs to see what, if any, economies can be introduced.

At present the method in almost general use of arriving at the cost of any article, is to set down in detail the value of the material used and the labor and then to add (either to the whole, or to the labor only) a certain percentage to cover the non-productive labor and factory expense. In many cases these figures are compiled with all possible care and the minutest detail; still, there is no proof whatever of their accuracy, because there is no agreement between the factory figures and the general books. Taking a foundry as an example, the above mentioned method might make the cost of one metal lower than the cost of another, with the result that the former one would naturally be used whenever possible in preference to the other; the installation of a correct method of arriving at the cost might prove beyond doubt that the former metal cost more than the latter, so that the Manufacturer was losing money by every substitution of one for the other. Again, the arbitrary method might show the cost of one finished article too high and of another too low, so that, when a period of depression comes around, the Manufacturer is only able to obtain orders for the article on which the cost is too low and has little or no demand for the article on which his cost is too high, with disastrous results at the close of the fiscal year.

A large proportion of manufacturers are undoubtedly aware of the shortcomings of their present cost systems and welcome the Public Accountant, who can add the missing links in their methods and weld them into a perfect whole. It should, however, be plainly stated that a complete cost system which will give the actual cost of each article manufactured, a running Inventory and a correct Profit and Loss account and Balance Sheet at the end of each month cannot be operated without a certain amount of additional expense, varying with the details of the business. There can be no doubt

but that this is more than compensated for by the information obtained by the Manufacturer, who, by an absolutely accurate knowledge of the cost of each article he manufactures, is able to successfully compete with his rivals.

CERTIFIED PUBLIC ACCOUNTANTS.

It may not be out of place to briefly call attention to the protection afforded by the employment of Certified Public Accountants, for it cannot be too widely known that the Act passed by the Legislature of this state is designed to protect the public, as well as the Accountant.

In the case of those who may be described as original members, the qualification was that of having practiced for five continuous years as a Public Accountant, prior to the passing of the Act, while others, who desire to obtain the decree, must undergo an examination in three branches of Accountancy and one in Commercial Law and obtain 75 per cent of the total number of marks to pass. In addition, strict inquiry is made in each individual case into the character of the applicant; the supervision of all this and the ultimate granting, or refusal, of the degree has very wisely been placed by the Legislature in the hands of the University of Illinois.

Just as no one would consult an unqualified doctor or lawyer, so should no one consult an unqualified Public Accountant, who stands in the same close and intimate relationship with his client with reference to his business transactions as his doctor and lawyer do in their respective spheres. This close relationship, however, has hardly yet been appreciated and brought into existence, for the idea is far too prevalent that the work of a Public Accountant is merely clerical checking and that statements and a report that the figures contained in them are correct, according to the books, are quite sufficient. If that were so, there would be no need on the part of the Public Accountant for any preliminary study of the subject, no need of any previous experience, no need to pass any examinations; all that he would require would be just a course in a business college, an office and a big brass plate with the words "Public Accountant" in large letters. But to those who desire to employ someone on whom they can rely to make an intelligent examination of their books, going below the surface and ascertaining the general correctness of the results shown, and from whom they will receive sound advice on any matters requiring notice, or who desire to consult with someone of experience on the result of their business, or on other important matters, it must be apparent that the title of C. P. A. is a guarantee of integrity and technical knowledge.

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MANUFACTURING STATIONERS AND OFFICE SYSTEMS.

Within the last few years there has developed a peculiar phase of accounting that has worked serious detriment not only to the profession, but to those who have been deluded into adopting it. Incorporated companies whose principal business is the manufacture of blank books and special rulings have found that the most effective way to provide themselves with a large market was to organize an accounting department. They employ men to visit merchants and manufacturers to whom they represent the advantages of proper system in the office or factory and state that they are specially fitted to introduce such systems, as they have accountants on their staff who make a specialty of such work.

In theory the scheme is a most excellent one, but in this as in everything else a half truth is worse than a falsehood. They are entirely correct in emphasizing the absolute necessity of a proper system, but in our opinion they are mistaken as to their own peculiar fitness to institute it.

The essence of effective work by a professional man must always be in its being absolutely disinterested. As soon as he allows any influence to weigh with him except the greatest good for his client his usefulness is at an end. There can be no question of divided allegiance.

If this be granted it cannot be denied that the accountant who represents, directly or indirectly, the seller of the supplies to be used in the system recommended must be subject to grave suspicion. Allowing, for the sake of argument, that he is capable of devising the best system, it still is true that his whole interest lies in the introduction of as many books and blanks as he thinks the business will stand. The principal business of his company is the manufacture and sale of special forms and they expect him to furnish a market for them. If he does not they will find someone who will. The result is that the victim is loaded down with a mass of stationery that is often not worth the storage room it takes up on the shelves, even if it is not a positive detriment as representing unnecessary repetition and detail in the accounts.

The independent accountant is subject to no such temptation. His first and only object is to give his client the best system for his particular needs. In carrying out this purpose he carefully studies the conditions and the methods already in use. As far as possible he utilizes the books and blanks to which the office is accustomed, so as to make changes that will involve as little confusion as is compatible with correct work. Where he is the regular auditor of the com-

pany he will frequently make the improvements gradually, so as to have each step thoroughly understood before another is taken, realizing that in many cases it is extremely difficult to obtain proper results from an office staff when every feature of the work is changed and entirely new ideas are brought into play. It usually requires time and careful attention to ensure the proper workings of all the details of even the simplest plan.

We submit to the serious consideration of the business man the question whether his interests are safer in the hands of the company whose principal object is to sell him all the stationery he can be made to take or in those of the certified public accountant, whose sole object is to give him the simplest and least expensive methods consistent with safety and a clear statement of all the conditions of the business.

THE AUDITOR AND THE SMALL BUSINESS.

The public accountant often receives as answer to his proffer of services, "That is all right for a large concern, but my business is so small that I can keep track of everything myself." This appears to be a valid reason for declining the aid of the accountant, but it seldom is really such.

It is a mistake to think that an audit is intended entirely to detect or prevent fraud. While the auditor does this in the ordinary course, his principal value lies in his knowledge of all classes of business accounts, by which he is fitted to give advice and to make such statements as will most truly set forth the conditions of the business. In doing this he invariably finds that he is educating not only the bookkeeper, but the proprietor as well, in the true principles of accounts and the proper reading of the message that they should convey.

As the business of the small concern grows all the departments are enlarged to meet the greater needs, except in the office, where the old methods, that may have sufficed in a way, are usually continued, although they are totally inadequate to the changed conditions. The competent accountant would have been able to modify the system of accounts so as to gradually take care of the increased demands in a far more economical way and with infinitely better results than are usually found where the office attempts to meet the emergency itself.

Finally, a serious question for each business man to ponder is whether it is worth his while to devote valuable time to the personal supervision of his office when he can have it done for him by a public accountant at a very small relative cost, leaving him free to devote his energies to the development of his business.

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THE ADVANTAGES OF THE PERIODIC AUDIT.

It would hardly seem necessary that the advantages of the Periodic Audit should have to be presented to the business man, and yet the fact remains that it is very requisite, for there can be no question that the experience of most Public Accountants is that a number of firms consider a single audit of their books, or a biennial, or a triennial one, quite sufficient for their protection.

The reasons for this conclusion are varied, the chief one appearing to be that the main, if not the sole, object some firms have in view when they decide to have an audit made is to ascertain whether there is any stealing or other dishonesty existing among their employees. Such firms consider the Public Accountant very much in the light of a detective and are apparently quite content if he is able to state in his report that his audit did not reveal any traces of their being robbed. Other firms think that it is an expense which need not be incurred annually and (while admitting the advantages of an audit) seem indifferent about the matter, but say, however, that they will very probably take it up again next year. There are also other firms who are willing, indeed, anxious, to have an audit and who, with a certain air of frankness, say they know their present methods of bookkeeping are not up to date and that they are very desirous of having them improved, and ask especially that the report shall contain suggestions to this end. When the report is received they hand it over to their Bookkeeper with instructions to make all the changes recommended, and then forever dismiss the matter from their minds, satisfied that they have had an "expert" examination of their books and that from now on their Bookkeeper will be enabled to keep them on the most approved and latest methods.

It is only possible in a brief article to state some of the reasons which render a regular Periodic Audit desirable, and certainly comes, firstly, the influence which a periodic audit has on the office staff and their work. How often at the first audit, when an examination about a certain entry is asked for and the Bookkeeper himself has forgotten the circumstances and, consequently, has to spend some time looking it up, does the Bookkeeper say that he did not anticipate ever having his books audited when he made the entry, or he would have inserted the explanation, and adds with earnestness that there shall be no cause for similar complaints at the next audit. In such cases the Bookkeeper is almost always sincere in what he says and in the future will take pride in having his own work and that of any under his control in proper shape for

the next audit, but if no second audit is made, it is not surprising if the Bookkeeper becomes indifferent, thinks his employer does not care how his work is done and gradually relaxes his efforts to have it in good shape. Secondly, there is the matter of the report and statements submitted at the conclusion of each audit. Through careful analysis of the transactions of the business, statements can be prepared setting forth the figures of the period under review, in comparison with the figures of the corresponding preceding period, and attention can be called in the report to any special items, or to any special circumstances, in connection with any large increase or decrease. Thirdly, Periodic Audits afford much greater protection than intermittent ones, because the Accountant is able to take up his work at each audit at the exact point he left off at on the previous one, which, in the case of the Cash and Bank balances, is most desirable.

The foregoing are three of the principal advantages of Periodic Audits, but by no means exhaust the list. It is probably only a question of time before the majority of business houses (large and small) will desire an independent report on, and statements of, their transactions year by year, with the accompanying satisfaction of knowing that their Books are under the continuous supervision of a Certified Public Accountant, and this desideratum can only be attained by Periodic Audits.

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Articles appearing in THE AUDITOR are not to be read as having received the endorsement of the society, but are to be taken as individual expressions of opinion, and as such may be answered in future issues. The Editor invites contributions from all Accountants.

The International Congress of Accountants, the first ever held in the United States, met on Monday, Tuesday and Wednesday, September 26th, 27th and 28th, at the World's Fair, St. Louis, at which Practicing Accountants from every part of the United States and Canada were present. Among others, the following delegates from British and Canadian societies were in attendance:

F. W. Pixley, F. C. A. (Ex-president of the Institute of Chartered Accountants in England and Wales), London, Eng.

J. Martin, F. S. A. A. (secretary of the Society of Accountants and Auditors), London.

E. A. Van Dien (of the Holland Society of Accountants), Amsterdam.

John Hyde, F. C. A. (Can.) (president of the Dominion Association of Chartered Accountants), Montreal.

John W. Ross, F. C. A. (Can.) (president of the Association of Accountants in Montreal), Montreal.

The Congress was held under the auspices of the Federation of Societies of Accountants in the United States and the objects were to secure the better recognition of Public Accountants and to promote uniformity of practice.

The proceedings opened with a reception by the Hon. David R. Francis, president of the St. Louis Exposition, who welcomed the members of the Congress and gave an interesting address on the subject of the Exposition, its educational and artistic features.

The president of the Congress, Mr. J. E. Sterrett, C. P. A., of Philadelphia, gave an instructive address, after which the following papers on Municipal Accounting were read and discussed:

"Brief History of the Movement Toward Uniform Municipal Reports and Accounts in the United States," by Harvey S. Chase of Boston.

"The Municipal Balance Sheet," by Henry W. Wilmot, A. C. A., C. P. A., of New York.

"Revenue and Expenses as Distinguished from Receipts and Disbursements in Municipal Accounting," by F. A. Cleveland, Ph. D., of New York.

"Appropriations," by Ernest Reckitt, C. P. A., of Chicago.

A number of other interesting and important papers were also read at the Congress. Mr. George Wilkinson, C. P. A., of New York read a paper on the "C. P. A. Movement and the Future of the Profession of the Public Accountant in the United States of America." Mr. Francis W. Pixley, F. C. A., of London read a paper on "The Duties of the Professional Accountant in Connection with Invested Capital Both Prior to and Subsequent to the Investment." Mr. A. L. Dickinson, F. C. A., C. P. A., of New York contributed a paper on the subject of "The Profits of a Corporation," while Mr. Robert H. Montgomery, C. P. A., of Philadelphia discussed "The Importance of Uniform Practice in Determining the Profits of Public Service Corporations Where Municipalities Have the Power to Regulate Rates."

At the Wednesday session, Mr. Walter A. Staub, C. P. A., of Philadelphia, read his essay on "The Mode of Conducting an Audit," which won a prize of \$50 awarded by the committee for the best essay written by a clerk in the office of a public accountant.

The social features of the Congress were a reception by the Hon. Rolla Wells, mayor of St. Louis, at the Hamilton Hotel, Monday evening; a banquet at the Mercantile Club Tuesday evening and a luncheon at the Tyrolean Alps on Wednesday.

At the banquet a loving cup was presented to Mr. George Wilkinson, secretary of the Federation, in general recognition of his efforts in bringing about the Congress and for his work on behalf of the Accountancy profession.

The Congress was considered by all a splendid success and the beginning of many similar gatherings.

The papers read at the Congress and the discussions thereon will be published in future issues as space will permit.

The Society of Accountants in Edinburgh will celebrate the fiftieth anniversary of the grant of its charter next month. This is the oldest Society of Public Accountants in the world, although there are several firms of Accountants in existence in England to-day who were established long prior to the formation of that society.

A new field of usefulness is being opened for the public accountant that bids fair to become of great importance. We refer to the work of "business counselors." Several accountants have lately found it to their advantage to let the public know that they are willing to act in this capacity, and some have found it to be a pleasant and profitable feature of the accounting business. It is undoubtedly true that no class of business men is so well qualified by training and experience to form correct opinions on business questions and offer practical suggestions for the improvement of conditions as the accountant, who has seen the "very inside" of the most ably conducted enterprises in the land.

Not long ago a manufacturer called in an accountant and told him he was not securing the amount of profit that he thought he could reasonably expect, and added: "Now you look around and see if you can find any leaks that I have overlooked." The accountant looked around and kept on looking around. He went from the engine-room to the roof, and at the end of two weeks he had something to say, and what he said (considerably boiled down, however) was as follows: "Your boilers are too large, since they generate fifty horsepower per day more than is needed, thus wasting fuel. Your box making material is not on the same floor with your packing department, and a lot of valuable time is wasted running downstairs for supplies. Have the freight elevator boy (who is now idle three-fourths of his time) keep a supply of all sizes of boxing material within reach of the packers. You have five No. 3 machines set up and connected when you have never sold the output of three. The space occupied by the two idle machines costs you twenty dollars per week. Take out the No. 3 machines and trade them for No. 1 machines and manufacture a staple that will at least pay rent for the space. You have some mills on the third floor that are only running to one-third of their capacity, though it would cost no more for space and labor to triple their output. Go to a jobber and sell him the surplus output of which these mills are capable. He will take it if the price is right, and you can undersell any other manufacturer, because your own trade with the retailers pays the expense of the milling department and a profit beside, so that you can make more money on what you sell the jobber at a lower price than your competitors are making at their prices. I have looked over your selling department. I find that your young men are writing long letters trying to convince a customer who has returned some goods that he was mistaken in their quality.

They are driving the customer away by insinuating that he doesn't know good goods. The customer writes that he has tried them, found them no good, and therefore returns them. Whenever that happens tell the young men to write the customer that the goods are received and he has been credited with them. That the house deeply regrets that they proved unsatisfactory and that an investigation will at once be made to fix the responsibility for the fault that is to be found with them. Write him that you are really under obligations to him for bringing the matter to your attention, and ask him in the future to feel perfectly free to return anything he buys of your house that does not grade up to the proper standard. Then you will keep your customer. I notice also that you are paying your salesmen salaries that run all the way from 2 to 18 per cent of their sales. A fair salary in your business is 7 per cent of the sales. Readjust your salary list on this basis, and then arrange to pay your salesmen a commission of 7 per cent on all sales in excess of the volume necessary for them to earn their salaries. Some of them may not earn their salaries, but if they come near it the first year, give them a little more time, and if they are the right kind it will not be long until they will be running ahead. If you find some that do not progress at all, fire them. You can't get a salesman, in your line, to do his best on a salary that does not get bigger as his sales increase; besides, the goods he earns a commission on are the most profitable to you because traveling expenses have not been increased to accomplish their sale, nor have the expenses of administration been any greater."

The manufacturer is following this advice and finds his profits rising as he puts it into effect. This was a piece of "business counsel" and it was worth many times its cost. There are many more business houses needing just this kind of an inspection, and it is encouraging to know that managers are beginning to find it out.

There is much discussion among accountants as to what prices are fair and proper for their services. None of them, so far as known, has expressed the opinion that any concerted action should be taken to fix a uniform scale of prices, and it is to their credit that they have not done so. No good result could come from action of this character, while the profession could be much harmed thereby. While this is true, it does not follow that the situation as to prices is as it should be. On the contrary, it is reasonably certain that much work is done too cheaply. This usually results from

a desire to increase the volume of business, whatever the effect may be on the rates of net profit. Another cause is the fear that a competitor will get the engagement and thus gain some unknown advantage. Still another cause is the practice of making a "lump" price for a piece of work, when every accountant knows that no man can tell how much time will be required to finish a given piece of accounting. There are so many contingencies which may arise to prolong the work, that any "lump" price given is a "blind guess." Should the work require less time than has been estimated then the client has been wronged, if the estimate was based on a fair time rate. There is no reason for this species of gambling. The client should pay for the time actually necessary to do the work, and no more. The accountant should receive compensation for all of the time given to the work, and no more. Why then should an arrangement be made, whereby one party or the other is almost sure to get the worst of it? It would certainly seem better for accountants to refuse to quote any other than a time rate, thus in a large measure cutting out the habit some business men have of "hunting bargains" when engaging an accountant. With the "lump" price done away with much hurtful and unprofitable competition will be avoided. The choice of the accountant will turn on personal preference, as it should. When told that another accountant has quoted a lower rate, the response should be that his valuation of his services is a matter for his own decision, and that if he regards the price given as representing their value, no one can safely dispute him. It will be found uniformly true that the client will not value an accountant's services at a higher price than the accountant himself puts upon them. The cure for all troubles concerning prices will be found in, first, declining under any circumstances to give competitive figures on work (except in cases of municipal corporations, where competition is required by law); second, declining in all cases to give a "lump" price on work; third, fixing the rate to be charged at which the services are fairly worth, and sticking to the rate. If all accountants will adopt these simple rules the cause for complaint of unstable rates will soon disappear. It is better to serve one hundred clients per year and enjoy a gross income of twenty thousand dollars, than it is to serve three hundred with a resulting income of thirty thousand dollars. It doesn't matter much what the *volume* of a business is, it must be judged by its *net profits*. Accountants need to take some of the advice they give to their clients.

DUTIES OF THE PUBLIC ACCOUNTANT.

The profession of public accountant is of comparatively recent origin, and there are many persons, especially in this country, who have but a vague idea of its scope.

Within the last few years recognition has been given to the accountant in a few of the states of the Union by the passage of laws granting a degree of Certified Public Accountant to anyone who can qualify for it under rules that are sufficiently rigid to ensure the selection of competent men. These men, thus entitled to use the initials C. P. A. after their names, form a body of trained and experienced accountants, whose usefulness to the business public is gradually being recognized.

There are still a great many misconceptions of the kind of service rendered by the accountant. Many persons think of him as an expert in the mechanical use of figures, able to add up a column in the twinkling of an eye, and have no conception of his true functions as business advisor and confidential counselor. It is hardly possible in a few words to enumerate all the duties of an accountant. We can glance at only a few of them at present.

THE AUDIT OF ACCOUNTS.

This comprises a critical examination of the books of account at stated or irregular periods, so as to be satisfied of their being kept honestly, not only as regards the relation of the bookkeeper to his employer, but also that of the managers to their directors and stockholders or absent partners; the preparation of an annual balance sheet and profit and loss statement, with a sufficient scrutiny of inventories to be satisfied of their substantial accuracy, and a certification of the condition of the business as shown by the accounts. In doing this the accountant is obliged to have sufficient experience to properly consider questions of depreciation of fixed assets, such as machinery, the value of open accounts receivable and many other similar problems. He should also be able to advise the management in regard to many points in the conduct of the business, preparing comparative statements to prove or illustrate his recommendations.

It will be seen that much more is involved in such an examination than the mere verification of the arithmetical accuracy of the books and the correct financial balance.

INVESTIGATION OF FRAUD.

In cases where fraud on the part of the bookkeeper or cashier is suspected the services of a trained accountant are usually indispensable, as the fraudulent entries may be so skillfully made that they may not be discoverable by any other.

INSTITUTION OF OFFICE SYSTEMS.

The trained accountant is the only person who can be depended upon to formulate a complete system of accounts for an office that will meet every possible need of the business with the least expenditure of time and labor on the part of the office force and the employment of the smallest number of books and blanks. No reputable accountant will accept a commission from a stationer on books or printing to be furnished to a client, and therefore he is not even remotely interested in multiplying books or forms, but is free to exercise his practical scientific knowledge of accounts in the devising of the simplest and most expeditious methods. In his regular practice he has access to such an infinite variety of accounts that he is not liable to become the advocate of any single method, but is able to adapt himself to the special requirements of the business under consideration.

COST ACCOUNTS.

There is nothing more important to the manufacturer than the exact determination of the cost of his various products. Cases without number could be cited where the institution of correct methods has led to startling developments of error in even the most careful estimates. Many manufacturers are unwise enough to begrudge the small increase of expense necessary to carry out the needed reforms, as they are unable to see the great advantage to be derived from a thorough knowledge of their business in all its details.

INVESTIGATIONS AS TO VALUE AND EARNING POWER.

When contemplating investment in an established business it is becoming more and more the habit of the prudent man to demand an examination of its condition by the public accountant, no longer depending on the statements made to him by the secretary or other agent of the selling party. However honest the latter may be, he is liable to be influenced by the desire to make out a good case, besides lacking the special training that would enable him to judicially scrutinize all the points that should enter into a proper statement. In connection with a valuation made by a skilled appraiser, the report of the accountant will furnish an unbiased exhibit of the earning power of the business in the past and will show whether the earnings are on a rising or a falling scale, as a guide to the future. It will also give a sound basis for the valuation of the open accounts and a reasonable guide to the amount that should be allowed for good-will. In the case of bonds offered on the public market, such an examination should always be insisted on by the purchaser.

BANKRUPTCY AND EXECUTORSHIP ACCOUNTS.

Receivers and executors seldom understand how to open the accounts of their trusts, to carry them on in accordance with the requirements of the law or to make proper reports to the courts. Unfortunately in this country the courts are so ignorant of the fundamental principles of accounts that they allow any report to be filed that is not objected to by some party in interest. In one recent case in the Probate Court of Cook County, Illinois, an executor began his second year's report with a cash balance on hand that was several thousand dollars less than the amount with which he closed his report for the first year. The report was accepted by the court without question until a creditor of the estate discovered the error. If the courts insisted on a proper supervision of this class of accounts by certified public accountants there would be much saving of trouble and expense in the settlement of estates.

There are many other ways in which the accountant can render valuable service to the public, the discussion of which must be left to future issues of this journal. Our present object will have been accomplished if we have succeeded in showing the business man that there is at his service a force of trained men who are as invaluable to him in his office as the scientific machinist is in his factory or the chemist in his laboratory.

In our last issue it was stated that the Board of Examiners appointed by the University of Illinois had not disposed of more than half the applications for the degree of C. P. A., although the Act had been in force for over a year. This was not correct, as it appears that out of 117 applications filed under the waiver clause, 92 have been passed upon. A list of the names to whom certificates have been granted up to September 28th, is given on another page of this issue.

The annual convention of the Illinois Bankers' Association is to be held at the Illinois State Building, World's Fair, St. Louis, Mo., on the 18th and 19th of October and promises to be interesting.

The Illinois Society of Certified Public Accountants will be represented on this occasion by Mr. Seymour Walton, C. P. A., who will read a paper on "Publicity" on Tuesday, the 18th of October.

Mr. Walton is the duly accredited delegate from the Illinois Society of Certified Public Accountants.

PROFITS OF CORPORATIONS.

BY SEYMOUR WALTON, C. P. A.

The end and aim of all business enterprise is the making of a profit on the transactions entered into. All the energies of proprietors and employes are expended with this sole object in view, the amount of the profit being the measure of the success attained. This being the case it is extremely important, in fact imperative, that correct ideas should be held as to what constitutes legitimate profit. Failure to properly discriminate between apparent and real profits has often led men to take steps that have eventually brought disaster.

It is well to understand thoroughly at the outset that any statement of the profits of a business is only an estimate until the business has been wound up. This arises from the fact that the profits depend on the value of the assets as shown in the Balance Sheet. Any reduction in the value would have to be provided for out of profits which would be reduced to that extent. It is therefore extremely important that the greatest care be exercised in scrutinizing all asset accounts with a view to determining whether they are carried on the books at a figure which they can reasonably be considered worth.

There are many ways of reaching an erroneous figure in calculating the profits of any given period, some of which are almost too false on their face to deserve mention here, but others have an insidious character that is very apt to deceive, owing largely to the different methods of figuring on the cost of goods. As the inventory is the basis of all profit figuring, it is there that we are most apt to find errors that may lead to false results. Closely allied to these errors is that of calculating on profits before they are actually realized, even to the extent of paying dividends out of profits that exist only on paper.

In an inventory nothing should be put down at a higher figure than its actual cost. The cost will include all the elements direct and indirect that are necessary to the production of the goods. The practice of listing finished articles at the selling price, less the supposed cost of selling, is common, but cannot be defended unless some way is found to guarantee the future market prices and also the selling conditions. The cost of selling for previous years is not always a safe criterion for the coming twelvemonths. With a given number of salesmen on the road, the comparative cost varies to a certain extent with the volume of business done, so that a diminished trade would increase the selling cost and impose an additional burden on the current year that may be already showing bad results, owing to the reduced volume of trade and a consequent reduction in gross profits.

There is great liability to error, and at the same time an opportunity for considerable difference of opinion in the way in which the value of machinery and permanent tools is treated. The consensus of opinion would seem to require that each article shall be charged to investment at its cost, including the expense of installing it in running order, and that such proportion of its cost shall be covered by a credit for depreciation each year as will extinguish the item at the close of its estimated life. The fact that the machine may be as good as new at the end of one or two years is no argument in favor of carrying it for that time at its original value, since the depreciation begins at once and should be equalized over all the years that the machine is expected to live. On the other hand it is not fair to the year in which a machine is bought to consider it at once as secondhand or to value it at what it would bring at forced sale, as some ultra conservative manufacturers do. A machine is valuable because it is capable of doing a certain amount of work for a certain number of years, and its cost is properly chargeable to each of those years alike.

A custom that may lead to serious error, but which is frequently defended by manufacturers who indulge in it, consists in inventorying raw material at the market price when that is greater than the actual cost. It is claimed that the advance in price is a legitimate profit of the year in which it occurred and the Profit and Loss account is given credit for it while it remains as only a possible profit in case the market does not drop before the material is made up and sold. The broad principle should be adopted that no profit can be depended on as made until the goods are actually sold.

One of the most perplexing questions in this connection concerns the value of real property. If a factory is started on land bought in an improving neighborhood and the market price of the land doubles in any given time, is it right to carry the land on the books at its increased value and thus offset the cost of replacing the building which has deteriorated to an equal extent? At the first blush it would appear to be a proper thing to do, but it will not be so plain if we ask in what way the business has been benefited by the accidental rise in value. If conveniences in the way of better shipping facilities or cheaper railroad connections have tended to lessen the cost of handling the goods, some increase in valuation may be allowed as an expression of the value of the saving of expense, but if all conditions remain the same and the land is of no more value to the business than be-

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fore, it is difficult to see why the profits of the business should be swelled by the admission of an unrealized element, still less why a dividend should be based on such a gain. If the land is actually sold and the factory moved to a cheaper location there would be no objection, but until it is actually sold, the profit is not realized and therefore not made. There is nothing to guarantee the stability of the new market price, which may drop back to the old figure and necessitate some awkward entries to the debit of the Profit and Loss account, especially if the supposed profit had been divided in cash among the stockholders. In a celebrated English case it was decided that the directors were personally liable for money thus paid out in dividends based on the increase in value of land, which was not sold and which subsequently depreciated to such an extent as to impair the capital of the company.

An instance of false profit figuring came to the writer's notice recently. In a consolidation of several companies into one, the capital had been placed at an amount that represented the assumed value of all the plants and good-will. It is needless to say that it was considerably more than the actual value. One of the recipients of the new stock sold back to the company one hundred thousand dollars face value of the stock for fifty thousand dollars cash. The nominal profit of fifty thousand dollars thus made was credited to operating profit and a statement was made to prospective purchasers, embodying this credit. The managers of the company felt aggrieved when the accountant eliminated this item from the profits of the period. The incident shows the advantage of employing the trained public accountant to verify figures made up by even the most honest secretary.

In view of all these facts there can be no doubt that it is by far the safest plan for the average company to have its profits determined by a Certified Public Accountant who is trained to look at things from a practical, scientific standpoint and who is not interested in making a good showing, as the officers of the company almost always are. The temptation is often irresistible to adopt that view of the year's profits which will be most flattering to the management. Without any intention to deceive, the wish becomes father to the thought and a totally erroneous statement is put out by the officers who are thoroughly honest and conscientious. The trained accountant is disinterested and unprejudiced and should be scientific enough to be able to discriminate between profits that are real and those that are, as yet, unrealized.

CURIOUS BOOKKEEPING METHODS.

WALTON, JOPLIN & CO., C. P. A.

A book has been written on the "Curiosities of Literature." Almost as large a volume could be compiled from the experiences of public accountants about the curiosities of accounts. We suggest to THE AUDITOR that it invite from its readers descriptions of peculiar methods of bookkeeping, and we will start the ball rolling in that direction by giving some of our own observations.

A dealer in books, whose business was almost entirely of a mail order character, kept nothing in the way of books except a cash book. When he bought goods he put the invoice that accompanied them in the left-hand drawer of his desk. At the end of the month, when statements were received from his creditors, he checked them with the invoices and in due time paid them. The unpaid invoices or statements in that drawer represented his "Accounts Payable."

When he received orders for goods they were entered on order blanks, which were consecutively numbered and deposited in the right-hand drawer of his desk. His bills to his customers indicated each shipment by its number. When he received a remittance he took from the drawer the order blank containing the number that appeared on the bill covered by the remittance, stamped it paid and filed it away in a permanent file, entering the amount of the remittance on the cash book. The orders remaining in the drawer constituted his "Accounts Receivable." No argument could convince him that this was not a perfectly satisfactory system of accounts.

Another case was that of two partners in a coal, wood and feed business in a country town. Again we found the cash book the only one that could be called an account book. This cash book had two columns on each side. The first one was allotted to "A," the senior partner, and the second to "B," the junior. When "A" received any money he charged himself with it in the first column on the left-hand page; when he paid out anything for goods purchased or for any expense of the business, he credited himself in the first column on the right-hand page. "B" did the same in the second column of the respective pages.

The difference between the two first columns represented the amount of money "A" should have on hand after charging himself with the drawings allowed him, and the two second columns represented a like liability on the part of "B." This ingenious arrangement seemed to work to the entire satisfaction of the two partners, until the death of "A" put an end to it.

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STOCKTAKING.

BY ALLEN R. SMART, C. P. A.

It is the generally accepted practice for Accountants to require the Inventory of Merchandise Stocks consisting of Raw Materials, Stock in process of manufacture, and Supplies to be priced at cost, or market value, whichever is the lower. There are, however, many cases when exceptions should be made to this rule, at least when using the amount of the Inventory for arriving at the profits of the business for the year.

The cases referred to are those of a manufacturing business which carries large stocks of raw material which fluctuate in market value. The cost or market value may be much higher at the end of a given year than at the beginning. If these prices (cost or market) are used the result is that a large fictitious profit is shown, viz.: the difference between the prices at which the Stock was priced at the beginning of the year and the corresponding prices at the end of the year. A year or two later the market prices may fall and the opposite result is brought about. Consequently when a comparison of the profit of one year with another is made there is frequently great disparity, although the total amount of business done may have been practically the same.

It may be stated in general that when business is exceptionally good and market prices are steadily rising, nearly all manufacturing concerns show large earnings, part of which is legitimate and part fictitious as above stated, and on the contrary when business is slack and the market prices are falling, the earnings shown are disappointing; because in the first place the legitimate profits are less and secondly there is a loss on the Stock to be provided for.

To the trained Public Accountant these conditions are understood, but the investing public, not having access to the details on which the profit shown has been made, lose confidence and throw their stock on the market, thus causing a further depreciation in values.

It may be well to remark here that it is a necessity for most manufacturing concerns to keep large stocks of raw material on hand to prevent a shutdown of the works in case of delay in delivery by reason of a shortage of freight cars or other obstruction to the regular receipt of material; and, while the orders for future delivery may, in prosperous times, cover all stock on hand at profitable prices, still this is not often the case in dull seasons.

To remedy this condition some very con-

servative firms take a lump sum off the total of the Inventory when prices are high, which is what Accountants refer to as a "secret reserve." The principal objection to this plan, however, is that the statement of Assets and Liabilities is incorrect. The plan recommended by the writer is to establish a price a little above low market price and use this price every year in figuring the Inventory for use in closing the Profit and Loss Account. Then refigure the Inventory at cost or market price, whichever is the lower, and use the total of this Inventory in the statement of Assets and Liabilities. The difference between the two Inventories can be shown in the Balance Sheet as Reserve for adjustment of Inventory.

There are some matters of detail in connection with this plan, which cannot be explained in this article on account of lack of space, but if such a plan be adopted in the main, the Profit shown will be legitimate, because the fictitious profit or loss on normal quantities of stock, by reason of the fluctuating market price, will be almost, if not entirely, eliminated.

DEPARTMENT ACCOUNTS AND THE PROFIT RATING OF EXPENSES.

Of late years, owing to advanced methods in bookkeeping, a large number of jobbing houses keep the accounts of various departments separate and show, at all events, a gross or trading profit for each department. This gross profit is arrived at by crediting the department account with the sales and the inventory at each closing period and charging the account with the inventory opening, purchases, freight and the wages of those actually employed in the department, the balance being the gross profit made by the department. The balances of the various department accounts are transferred to the credit and the various expense accounts to the debit of "Profit and Loss" account, the balance being the net profit or loss. Some firms go a little further than this, and charge the department accounts with a proportion of rent and with interest on the capital employed. But there is a marked disposition on the part of some firms to go further still and to ask the accountant, when auditing, to prorate the whole of the expenses against the departments, and it is here that difficulties are encountered. It would be more correct to say the items on both sides of the "Profit and Loss" account than the expenses, because on the credit side there would be discount received on goods purchased and perhaps other credits, while on the other side there would be discount allowed to customers, selling expense, general

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expense, bad debts and probably some miscellaneous charges. The writer invariably endeavors to persuade his clients to be content with a department result which is obtained after charging only the following: purchases, freight, wages, proportion of rent, taxes and insurance, and interest on capital employed, on the ground that to make an accurate distribution of the expenses would entail a vast amount of book-keeping, and that the gross profit of a department is quite enough information to show with what success the manager is running it. But some firms say that they must know the net profit of each and every department, as they are under contract to pay the manager a commission on same. If, therefore, it is absolutely compulsory for the accountant to prepare a "Profit and Loss" account for each department, it behooves him to be most careful in arriving at the proportion of each item in the "Profit and Loss" account to be charged or credited to each department. It is impracticable to use a percentage on the sales, for it may take twice as much traveling expense to sell one department's goods as another, and the purchases for one department may be subject to discount, while those for another be net. It would therefore appear necessary for the accountant to inquire fully into the conditions governing each department and to base the proportion of the items to be distributed more on facts than on figures, and even though the greatest carefulness may have been exercised, the accountant will be wise in stating clearly that the results shown are only approximate as to their division. Special measures must be taken, however, with reference to two items, rent charged departments where the building is owned by the firm and interest on capital employed, because it will readily be seen that as these two items are credited to "Profit and Loss," they have to be credited the departments with the result of simply nullifying the original debits. The best plan, probably, is to omit these entries altogether and show the total department profits equaling the profit shown by the "Profit and Loss" account, and then on a separate statement show the profit of each department and deduct therefrom the rent and interest, the balance being the profit of each department as affecting the respective managers.

MEETING.

A meeting of the Executive Board of the Federation of the Societies of Public Accountants in the United States will be held Tuesday, the 18th inst., at Williard's Hotel, Washington, D. C.

ILLINOIS CERTIFICATES ISSUED.

Complete list of Public Accountants who have received Illinois C. P. A. certificates to September 28, 1904:

Augustus, Chas. Wm.	McKeand, C. A.
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Appel, Jacob M.	Mills, Edward M.
Bacchus, LeRoy L.	Millard, Henry.
Baker, Edwin R.	Morris, Chas. E.
Bentley, Arthur.	Nelson, Robert.
Boughey, Frank M.	Nigg, C.
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Marr, C. J.	Williams, John J.
May, Geo. O.	Wilmot, H. W.
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Mr. George Wilkinson, secretary of the Federation of Societies of Public Accountants, paid a flying visit to Chicago recently and was welcomed by his old friends of the Illinois Society.

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Ludlam, Chas. S..... 204 Dearborn St.
Macdonald, R. O..... 802 Marquette Bldg.
Marr, C. J..... 1730 Tribune Bldg.
May, George O..... 1730 Tribune Bldg.
McKeand, C. A..... 314 Royal Ins. Bldg.
Nelson, Robert..... 135 Adams St.
Niven, John B..... 30 Broad St., N. Y.
Parke, F. K..... 119 Monroe St.
Pickett, L. S..... 314 Royal Ins. Bldg.
Reay, Wm. M..... 7 Monroe St.
Reckitt, Ernest..... 802 Marquette Bldg.
Ring, Richard F..... 314 Royal Ins. Bldg.
Seatree, W. Ernest..... 1730 Tribune Bldg.
Sells, E. W..... 204 Dearborn St.
Smart, Allen R..... 314 Royal Ins. Bldg.
Sprung, F. W..... 802 Marquette Bldg.
Stallings, A. J..... 314 Royal Ins. Bldg.
Stanley, Edward..... 1730 Tribune Bldg.
Turville, Geo. A..... 1730 Tribune Bldg.
Walton, Seymour..... 238 La Salle St.
Webster, Geo. R..... 1730 Tribune Bldg.
Wilkinson, George..... 802 Marquette Bldg.
Williams, John J..... 802 Marquette Bldg.
Wilmot, H. W..... 1730 Tribune Bldg.
Young, Arthur..... 1633 Monadnock Blk.

ASSOCIATES

Brown, John H..... 1722 1st Natl. Bk. Bldg.
Greig, A. F. Rattray..... 619 Royal Ins. Bldg.
Laurie, John..... 1730 Tribune Bldg.
Millard, Henry..... 101 Washington St.

JUNIOR

Cullen, W. H..... 1722 1st Natl. Bk. Bldg.

Secretary's Office
315 Royal Insurance Building
Chicago

Articles appearing in THE AUDITOR are not to be read as having received the endorsement of the society, but are to be taken as individual expressions of opinion, and as such may be answered in future issues. The Editor invites contributions from all Accountants.

Our last issue seems to have pleased a number of people, judging from their commendatory expressions, and we are encouraged to "keep it up." Of course we would have kept it up, even though we were compelled to dodge brickbats; but it smooths the way and lightens the task to have our efforts appreciated. To those friendly souls who know the value of a little encouragement, we have to say that we expect to be found pounding away at the same old stand for many moons; certainly as long as there remains a reputable business house, within our "sphere of influence," unconvinced that the services of a Certified Public Accountant are a positive necessity.

In our last issue there appeared an article on "Stocktaking," which dealt with the practice of pricing the raw material on hand at Market price. It was pointed out that in cases where a large quantity of raw material was necessarily carried in stock, the fluctuation in price resulted in a showing of fictitious profit or a loss, according to whether the Market price was high or low. Since this article appeared in print, the Annual reports of two important Iron and Steel Companies have been published. From these reports it appears that in one case \$669,616.41 and in the other \$695,640.00 was written off raw and finished materials to adjust the Inventories. In one case it is shown that in 1901, \$158,527.00 was charged off in a similar manner.

It clearly appears that both these Companies have been showing earnings in the two former years, part of which were made from increasing the prices at which the raw and finished material on hand were figured. This clearly shows the danger of pricing Stock in Trade at Market prices for the purpose of figuring Inventories, when such stock is subject to market fluctuations.

From the published reports it does not appear that either of these Companies employ outside Auditors; had they done so it is probable that the danger of inflating the profits would have been called to the attention of the Board of Directors in such a convincing manner that it would have been

provided against. The Directors would ensure the confidence of the Public and relieve themselves of much responsibility if they would elect an outside Auditor.

In his address before the Illinois Bankers' Association, Mr. Ridgely, the Comptroller of the Currency, made an earnest plea for more effective supervision of the banks by the directors. While giving due credit to the official examiners, he rightly claimed that no bank examiner was able to give sufficiently thorough attention to the affairs of a bank in the limited time at his disposal and then he made the significant statement: "The directors should have frequent thorough examinations made by committees of the board or experts employed for the purpose."

It is a great point gained by the public accountant, when the head of an important department of the government thus publicly recommends the employment of outside examiners to supplement the work of his own official staff. Accountants have long recognized the value to the banks of such examinations, but we are of the opinion that this is the first time that they have been recommended by the chief of the bank department of the general government.

At the convention of the Illinois Bankers' Association last month, there was an example of the way in which system men are reaching out for business that should belong to the certified public accountant. On a table in one corner of the room in which the bankers assembled there was displayed a complete set of bank account books devised by a well-known company whose principal business is the selling of special rulings, and who claim to be accountants, and behind the table was a very suave young man who was ready to show the books and to descant persuasively on their merits. The books were very fine specimens of ruling and printing, and the bindings all that could be desired for service or appearance. There were also for free distribution, paper weights in the shape of a turtle made of brass and enamel inscribed, "Swim Out of Your Accounting Troubles. We'll Throw You a Life Line," followed by the name of the company. Altogether it was a most taking exhibit, and many of the bankers were giving it close attention.

Accountants know that while these system men have many excellent ideas, and

devise systems that are well suited to some of their customers, they are too prone to load a concern up with an elaborate outfit of blanks that they do not need. They are also apt to employ men who fall into ruts and insist on fitting the office to some pet system. But the general public is not so well posted in regard to the wiles of these smooth talkers and is frequently made to suffer for its ignorance.

It is difficult for the professional accountant to protect either the public or the profession from the men who are thus commercializing what should be a strictly professional matter. He cannot stoop to the drummer-like methods of the traveling salesman without losing his professional character. It would seem, however, as if some action should be taken by societies of accountants in the different states to enlighten the public as to the folly of entrusting the important matter of office and factory systems to those whose principal object is to sell as many blanks of as many varieties as the customer can be induced to take.

Now that the election has been held and officers chosen in a majority of states, it is time to call the attention of such officers to the necessity of having audited the accounts of all boards or commissions authorized to disburse State funds. The taxpayers of the State are as much entitled to protection in the matter of the proper disbursement of the State's funds as are the stockholders of a private corporation in the matter of expenditures by its officers and employes. Lax business methods in public places have continued long enough, and there can be urged no good reason why the stewardship of trustees should not be made the subject of impartial investigation by a disinterested public accountant. If the funds of the State have been properly and lawfully handled, the officers handling the same are entitled to have that fact known. If such funds have been unlawfully or improperly handled, the taxpayers and the general public are entitled to that knowledge. From any point of view, the proposition to have audited the books of the various boards and commissions handling State funds, is one that must meet with the approbation of the non-office-holding portion of our population—and it is somewhat the greater portion. Illinois has just elected as her next Governor a man of high ideals and good morals; a man who has demonstrated beyond question that he believes the oath subscribed to upon assuming the duties of a public office is a sacred one, to be respected in the spirit, in the substance and in the letter. The people of Illinois expect much of him and we feel that they will not

be disappointed. To fully satisfy them, however, we believe that Mr. Deneen should, upon assuming office, cause to be audited the accounts of all bodies disbursing State funds, and should serve notice on his appointees that their acts and doings would be subjected to a careful scrutiny by disinterested public accountants of his own selection. In adopting this course he would be merely applying to public affairs the policy pursued by all properly managed business houses; a policy that has so often proved its value as to need no recommendation and no defense. The only objection that will be urged to this proposition will come from those interested in concealing their acts and doings, and to such objections the Governor-elect cannot afford to listen. As we said before, if the funds have been properly handled the trustees are entitled to have it known, and if they have been improperly handled the public is entitled to know it. Other Governors, while acknowledging the desirability of this action, have lacked the courage to carry it out in the face of the opposition of the politicians. We believe Charles S. Deneen has sufficient courage to do what is right, no matter who opposes his action. He owes none of his political advancement to politicians of the "stall fed" class, and he knows their opposition cannot hurt him. On the contrary, he knows that the people of every State may be depended upon to support officers who do their plain duty under the law. We believe Mr. Deneen will see the public benefit and the party advantage that will accrue from the adoption and execution of the policy we have outlined, and that he will be found at the proper time carrying it into effect.

The Chicago papers of November 12 contained the news of the conviction of two trusted bank employes charged with the embezzlement of \$20,000 and \$90,000, respectively. The general public, upon reading this news, probably gave a grunt of satisfaction that the penalty of the law for such wrongdoing had been exacted, and gave it no further thought. The officials of the looted banks probably congratulate themselves upon the fact that these embezzlers were industriously prosecuted, and cheer themselves with the thought that the other employes now have before them some awful examples. Before these officials become too well satisfied with their actions in this matter it might be well for them to ask themselves whether the crimes for which these men are to be punished could not have been prevented and all of the loss and trouble avoided by having had their work looked into from time to time by competent accountants.

The deterrent effect of frequent auditing

on an employe of weak moral structure is indisputable. Hundreds of the best business houses in Illinois have the accounts of their trusted employes audited regularly, though they are reasonably certain that nothing wrong will be found. They know, however, that temptation is not so likely to beset an employe when he knows that his wrongdoing is sure to be discovered when his accounts are examined, and knows they will be examined at a comparatively early date. The directors of these banks are not without responsibility in matters of this kind. If they had not been too shortsighted, or had not been "penny wise and pound foolish," these convicts might still be useful employes leading exemplary lives. What right has a board of directors to neglect to take every precaution, not only in protecting the safety of the funds committed to their stewardship, but as well in saving from temptation those who are in their employ? The question asked thousands of years ago, "Am I my brother's keeper," has been answered affirmatively. These directors share some of the responsibility for these crimes. To the extent that they failed to provide proper safeguards against the commission of these crimes, and to the extent that they made temptation greater, they are culpable.

Their duty to their trust and to society is not discharged by the conviction and punishment of the lawbreaker. If they could have kept him from being a lawbreaker by the exercise of reasonable precautions they are to that extent responsible for the crime. Their miserable ideas of economy have helped to make two formerly respectable citizens, convicted felons, and have aided in bringing disgrace upon aged parents, heart-broken wives and helpless children. Would it not have been better to have carried a few hundred dollars less to the surplus account, and have done what was possible to prevent these crimes? Directors need to ponder whether they are discharging all the duties they have assumed.

We regret to announce the recent death in Manchester, England, of Mr. Edwin Guthrie, Fellow and one of the seven petitioners to whom the Royal Charter of the Institute of Chartered Accountants in England and Wales was granted May 11th, 1880.

Mr. Guthrie was a leading authority on Municipal Accounting and actively connected with the Institute until his death. He enjoyed a large practice in England, one of his appointments being that of auditor to the Manchester Ship Canal, and he was also well and favorably known in this country.

THE "JAPS" KNOW A GOOD THING.

The following balance sheet discloses the fact that the Japanese—"the Yankees of the East"—know the value of an auditor's certificate. The balance sheet is interesting also in many particulars, sufficiently so, as we think, to justify its reproduction here:

FORTY-NINTH REPORT OF

THE YOKOHAMA SPECIE BANK, LIMITED.

(Yokohama Shokin Ginko).

Presented to the Shareholders at the half-yearly ordinary general meeting, held at the head office, Yokohama, on Saturday, September 10, 1904.

	Yen.
Capital subscribed	24,000,000
Capital paid up	18,000,000
Reserve fund	9,520,000
Directors.	
Nagatane Soma, Esq.	Yuki Yamakawa, Esq.
Kamenosuke Misaki, Esq.	Rokuro Hara, Esq.
Kokichi Sodona, Esq.	Ippai Wakao, Esq.
Riyemon Kimura, Esq.	

President—Nagatane Soma, Esq.
Vice-President—Kamenosuke Misaki, Esq.
Branch Offices.—Kobe, Nagasaki, Tokio, Dalny, Hong Kong, Newchwang, Peking, Shanghai, Tientsin, New York, San Francisco, Hawaii, Bombay, London, Lyons. Head Office—Yokohama.
To the Shareholders.

Gentlemen:—The directors submit to you the annexed statement of the liabilities and assets of the bank and profit and loss account for the half-year ending June 30, 1904.

The gross profits of the bank for the past half-year, including yen 426,667,884 brought forward from last accounts, amount to yen 6,489,418,194, of which yen 4,582,417,636 have been deducted for current expenses, interests, etc., leaving a balance of yen 1,907,000,558.

The directors now propose that yen 200,000,000 be added to the reserve fund, raising it to yen 9,520,000,000, and that 100,000,000 be placed to the silver funds. From the remainder the directors recommend a dividend at the rate of 12 per cent per annum, which will absorb yen 720,000,000 on old shares and yen 360,000,000 on new shares, making a total of yen 1,080,000,000.

The balance, yen 527,000,558, will be carried forward to the credit of next account.

NAGATANE SOMA, Chairman.

Head Office, Yokohama, September 10, 1904.

BALANCE SHEET (June 30, 1904).

Liabilities.	Y.
Capital paid up	18,000,000,000
Reserve fund	9,520,000,000
Reserve for doubtful debts	235,381,830
Reserve for depreciation of bank's premises, properties, furniture, etc.	607,345,000
Reserve for silver funds	400,000,000
Deposits (current, fixed, etc.)	72,772,029,062
Bills payable, bills rediscounted, acceptances and other sums due by the banks	94,674,192,114
Dividends unclaimed	5,194,520
Amount brought forward from last account	427,667,884
Net profit for the past half-year	1,479,332,674
	Yen 197,921,143,084

Assets.	Y.
Cash Account—	
In hand	6,664,228,250
At bankers'	6,860,130,990
	13,524,359,240
Investments in public securities	19,986,648,440
Bills discounted, loans, advances, etc.	51,895,124,020
Bills receivable and other sums due to the bank	110,284,672,504
Bullion and foreign money	161,514,930
Bank's premises, properties, furniture, etc.	2,068,823,950
	Yen 197,921,143,084

PROFIT AND LOSS ACCOUNT.

	Y.
To current expenses, interests, etc.	4,582,417,636
Reserve fund	200,000,000
Reserve for silver funds	100,000,000
Dividend—	
Yen 6,000 per share for 120,000 old shares = yen 720,000,000; and	
Yen 3,000 per share for 120,000 new shares = yen 360,000,000.	1,080,000,000
Balance carried forward to next account	527,000,558
	Yen 6,489,418,194
By balance brought forward December 31, 1903	427,667,884
Amount of gross profits for the half-year ending June 30, 1904	6,061,750,210
	Yen 6,489,418,194

We have examined the above accounts in detail, with the books and vouchers of the bank and the returns from the branches and agencies, and find them to be correct. We have further inspected the securities, etc., of the bank, and also those held on account of loans, advances, etc., and find them all to be in accordance with the books and accounts of the bank.

NOBUO TAJIMA,
FUKUSABURO WATANABE,
Auditors

ADDRESS OF ARTHUR LOWES DICKINSON, M. A., F. C. A., C. P. A.

President of the Federation of Societies of Public Accountants in the United States. Delivered at the Third Annual Meeting of the Federation held at the New Willard Hotel, Washington, Tuesday, October 18, 1904.

Gentlemen:—I have to thank you for the honor you have conferred upon me in electing me President of this Federation. I feel that it is a position which at the present time calls for a great deal of personal work as well as tact on the part of the President, and it is, therefore, with some hesitation, that I accept that position, feeling that there are many who, in view of their closer connection with the various State Societies, and of the work which they have done on behalf of the profession over a long period of years, as well as from their acknowledged abilities and their acquaintance with the general body of Accountants all over the country, could have filled that position with greater advantage to the profession than myself. I will say, however, that you may feel satisfied that I am prepared to devote a large portion of my time to this work, and I will only ask that you will accord to me the same loyal support that has been accorded to the officers of the Federation in the past. I again thank you most sincerely for the confidence you have shown in myself in electing me to this important office.

Not the least important of the high aims which this Federation has, from its initiation, endeavored, and I believe successfully endeavored, to attain is that which requires that the position to which its officers are elected should be held solely in the interests of the Federation, and that the use or any suspicion of the use of that official position for the professional advancement of their own interests is a breach of that high standard which we are all endeavoring to set for our profession. I think it is perhaps a good thing that the incoming President should reiterate this principle and declare at the commencement of his period of office that he holds this position in trust for the benefit of the whole profession and should pledge himself not in any way to use it for his own personal purposes. I feel that this principle has been loyally observed by the officers in the past, and I am sure it will be equally loyally observed by those whom you have elected now, or may elect in the future.

Many of you have recently attended the first Congress of Accountants at St. Louis, and have listened to many valuable addresses and papers on the subject of the past and future of our profession, both in this country and abroad, and all of you who were not so fortunate as to be able to attend will shortly have the opportunity of

reading all those addresses in print; it seems, therefore, superfluous, especially in view of the report which our late Secretary, Mr. Wilkinson, has made to-day, to trouble you with any further remarks on that subject, and I propose merely to say a few words to you with regard to one or two essential features of our Organization and to the manner in which they are being cared for in the negotiations at present proceeding with the American Association of Public Accountants; and then to outline in a general way the most important matters which are likely to come before the Executive Board of the Federation during the ensuing year in the line of the general advancement of the interests of our profession.

It is customary that a President's address shall avoid controversial topics. In dealing with such subjects as I have mentioned above, it is not possible altogether to avoid them, but I shall endeavor to deal with them in such a way as to give, shortly, the facts on both sides and to suppress my own personal opinions in the matter as far as possible.

The subject which I think you will all agree to be at the present time of the most vital importance to the future of the profession will be fully dealt with in the report to be presented to-day to the Executive Board by the Special Conference Committee, viz., the possibility of extending the scope of our present National Society by affiliating with the American Association of Public Accountants. This body, as you know, was incorporated in New York in the year 1887, and was from that date until the formation of this Federation practically the only national Association in existence. Owing largely to the form of its Constitution and By-Laws, it remained throughout that period almost entirely a New York Society; its meetings were held in New York, its officers have been almost, without exception, New York Accountants, and while it has a fair scattering of members throughout the other States, it was generally felt that the interests of those members in outside States could not be attended to as they should be, if the Society were to be of a National character. It was from this general feeling in the States outside of New York, that the formation of the Federation of Societies of Public Accountants has sprung, and while we must all agree that its growth, I might almost say wonderful growth, during the past two years is due largely to our friend and late Secretary, George Wilkinson, it is based upon the desire, in the various States which have joined the Federation, for a real National Organization of which they could become

members. If this desire had not existed, and existed very strongly, all the work which has been so ably performed in the past two years would not have brought the Federation into the position which it occupies to-day, as the representative of the whole body of practicing Accountants in the country, exclusive only of the territory in the immediate neighborhood of New York City. But this exception is an extremely important one—the body of Accountants in New York is, and will probably remain, the most important individual body in the United States. Strong as the Federation undoubtedly is, and stronger as it undoubtedly will grow, it can never reach the ideal which its founders and its present members have in view, of the National Society in the United States, so long as the New York Accountants are not represented therein. This fact, which I think we must all admit, has been the basis of the attempts which have been made from time to time during the last two years to come to an agreement on national lines with the American Association of Public Accountants; and these negotiations are at present so nearly consummated that I cannot but think that when the details come to be examined, as they must be shortly by the Executive Board of the Federation, the chances of their acceptance thereby, and eventually by the constituent Societies themselves, are most promising. And here let me say that in such an agreement which has so nearly now been reached, it is essential that both parties should be prepared to concede whatever are not the essential principles of their belief. There is a great deal to be said for preserving the name and character of the body which was the first representative of the Public Accountants in this country, if that name can be attached to a real national organization. The essential principles for which the Federation has been fighting is that the national body must be, like the Congress of the United States, a body representing districts, and not individuals; that it should not in any way interfere with any action which individuals grouped in any district may choose to take, provided that it is within the lines laid down by the constitution and by-laws of the national body, and even then the national body cannot exert any pressure on the constituent bodies unless they, too, are acting contrary to their own charter. This principle is, I believe, largely through the influence of the Federation, admitted by the great body of accountants throughout the country, but there will always be a certain minority who are not in line with this idea, and who have, under the existing regulations of the American Association, certain rights of which they cannot legally be deprived. The policy

which will be laid before the executive board of the Federation is that of recognizing, for the sake of harmony, and the objects that can be attained by a great national body, the individual rights of this small minority, but at the same time refusing to extend those rights to other individuals. While this may not be an ideal conception at the present time, it has all the foundations of an ideal conception on the lines on which we have been working for the last two years in this Federation, and at the same time partly as the result of the experience of the Federation, it is possible to improve in some directions on our own organization. To one somewhat important departure from this organization I especially wish to direct your attention.

We are all working to extend the degree of Certified Public Accountant throughout the country, and at the same time to elevate that degree until it really comes to mean in fact what its title means in theory, viz.: That the holder of the degree is a person qualified in every way to practice as a Public Accountant. We also all know that at the present time the effective force of the degree is very much less than it should be, and that much hard work remains to be done before the mere fact of the acquisition of this degree means that the holder is qualified to practice. In the meantime, there are undoubtedly a large number of Accountants scattered throughout the country who are not Certified Public Accountants, and who for one reason or another cannot become so without passing an examination, which to a man of any age and experience would probably prove a fatal objection. Moreover, at the present stage such men may say that they do not see at the present time that the standard of the Certified Public Accountants is any higher than—or as high possibly—as their own, and it must be admitted that there is a great deal of force in this argument.

If the Certified Public Accountant degree is to be the recognized mark of the Public Accountant throughout the country, it must be so not only in name, but in fact, and at any rate until it is so in fact there will always be practicing Accountants who do not hold that degree and who are as qualified to call themselves Public Accountants as are the holders of the degree. Now, it will probably be admitted that a National Body, to be effective, must comprise all practicing Public Accountants in the country, and that if any considerable section remains outside that National Body it will be a danger to the profession and will certainly hamper, if it does not entirely prevent, its efforts to obtain National or State recognition. We have only to look at the results of the policy of exclusion practiced for

many years past by the Institute of Chartered Accountants in England and Wales toward the Society of Accountants and Auditors in that country to see what must result from the existence of two competing National Bodies. However high the standard may be of one as compared with the other, the former will never be able to obtain privileges for itself alone, because of the opposition of the other; and it is this sort of conflict between two bodies which our own National Organization should endeavor by all means in its power to avoid. If an attempt is made to confine the National Body either now or in the near future to a body of Certified Public Accountants, it is inevitable, as has happened in other countries, that there should grow up in conflict with it another body, the members of which are not so certified. The organization of the uncertified Public Accountants is one of the problems for the near future that demands the gravest consideration; and the points for consideration would seem to be: Firstly, shall they form a part of the National Organization? Secondly, shall they be individual members of that organization or shall they be organized into groups? Thirdly, shall those groups be groups by States or Districts affiliated to the Certified Public Accountant bodies already existing, or shall they be separate and independent Societies in those States or Districts, working in harmony with the Certified Societies through the National Body? The solution of this problem demands the most careful consideration, not only of the Executive Board of the Federation, but also of the Certified Public Accountant Societies in those States which have already obtained a Certified Public Accountant law or which may hereafter obtain one. The one essential feature which should be borne in mind, if a National Society is to be really National and effective, is that it must in one way or another control the whole profession without interfering with the rights, prerogatives or duties of the separate Societies, and this control, it would seem, will be impossible of attainment unless it extends not only to the Certified Societies, but also to the uncertified Societies as well. It will ultimately rest with those who have the degree of Certified Public Accountant to prove by their work that they are more fit to be trusted with the increasingly important duties which will fall to our profession than those who have not, for one reason or another, obtained that degree. One essential for the progress of the profession and its attainment of the position in the list of professions which we are all desiring is the preservation of the highest possible standard of attainments and conduct on behalf

of its individual members, whether they be Certified or Uncertified, and whatever action may be taken in admitting to the National Body the uncertified Accountants, it will have to be based on the same high standard that is already in process of adoption in eight States through the Certified Public Accountant law.

The prospects for the future, taking into account the probable successful outcome of the negotiations referred to above, are excellent. It is hardly necessary at this time to dilate upon the importance to the whole profession of a National Society. The Congress recently held at St. Louis, the whole idea of which originated with the Federation and which was carried out under its auspices, was a National one in every sense; and it has successfully shown that a far greater influence can be exerted by a National Body than by individual Societies acting in their own States. Any State Society taking individual action, either legislative or otherwise, will be stronger if there is a recognized National Body, representing the whole profession, upon which it can call for assistance at any time.

Federal recognition, which in the opinion of many must come sooner or later, can only be obtained by a National Body. An Accounting paper or magazine, representing all the Societies throughout the country and spreading abroad a knowledge of the duties and responsibilities of the profession and its value to the general public, can be established only by a National Body representing all these Societies. C. P. A. legislation in the different States can be materially assisted by such a National Body, and the example set by that Body in maintaining an increasingly high standard of attainments and conduct throughout the profession must be invaluable in the case of the formation of new Societies in States where they do not at present exist. Another branch of the work of a National Body which is contemplated is the appointment of a standing Advisory Committee to which the State Societies or their individual members can apply in strict confidence for opinions, advice, or assistance, in matters of principle, practice, legal rights, or etiquette, which may come up from time to time. Such a Committee, it is believed, will meet a real need, particularly in those States in which the number of practicing Accountants is limited. As a practical instance of the weight which a National Society carries may be mentioned the recent action of the Census Bureau in asking, through their official representative, Mr. Powers, for the appointment of a Committee of Accountants to join with that Bureau in a conference on Uniform Municipal Statistics, to be held in December next.

PRIVILEGED COMMUNICATIONS.

I may now refer to a few other matters which must shortly command the attention of the Executive Board, and perhaps the first among these is the attitude which the profession as a whole should adopt as regards the disclosure, under pressure of the Courts, of confidential information acquired in the course of their professional duties. In England the Courts admit generally the privileged character of these communications, and I believe I am correct in stating that an Accountant is allowed to plead privilege as an excuse for not answering questions on such matters. This position has been obtained not by statute but by an expansion of the ordinary common law doctrine on privileged communications generally. In this country, as I understand, no such privilege is as yet accorded to our profession, and yet the matter is of such vital importance that it may be safely said that any disclosure by an Accountant, under compulsion of legal process, of confidential information so acquired, would deal a blow, not only at the standing and position of the individual, but of the profession as a whole, which it might take years to recover from, if indeed, recovery were ever possible. It seems, therefore, incumbent on us that we should take some action at as early a date as possible to obtain by legislation in the various states an extension to our own profession of the doctrine of privileged communications, the benefits of which at present are accorded to lawyers, doctors and clergymen; and this is a matter which should undoubtedly receive the earliest consideration of the Executive Board.

EXEMPTION FROM JURY DUTY.

The matter next in importance from the point of view of the profession generally, would seem to be that of exemption from jury duty. This has already received some consideration in New York State, but no serious endeavors have, I believe, yet been made to obtain the extension to our profession of the rights which are at present granted to the other learned professions. In view of the fact that our duties are often of the greatest importance in point of time to our clients, and that serious loss may be at any time inflicted upon them and inferentially upon ourselves by the action of the jury law, it would seem desirable that steps should be taken by the State Societies to obtain exemption for the members of our profession.

A PRESS ORGAN FOR THE PROFESSION.

Another matter which has been discussed to a great extent from time to time is the establishment of a publication, whether weekly or monthly, dealing with the interests of our profession. The time seems to

be coming when this question should be seriously considered by the National Society. The Illinois Society has already started on its own account a small magazine, upon which it is to be congratulated as being the first effort of this kind; this may be welcomed as a beginning, but it cannot meet the real needs of the profession all over the country so well as could a publication produced under the auspices of the National Body and with the support of all the State Societies. There are many ways of dealing with this matter, but I think it will be generally admitted that whatever the publication is, it must be of the highest possible standard and worthy of the profession; that it should be a publication relying for its success not upon general commercial lines but upon the support of the whole profession, and it would also seem desirable, in order to make the standard as high as possible, that advertisements by individual Accountants should be excluded and in their place a list of the members of all the affiliated Societies should form a part thereof. This, too, is a matter of considerable importance which will require much care and deliberation on the part of the Executive Board and also much consultation with the various State Societies.

AUDIT COMPANIES.

In the very able paper read by our late Secretary at the recent Congress in St. Louis, some strong remarks were made on the subject of Audit Companies, which appeared to meet with the general approval of those assembled. The attitude which the profession as a whole should take towards these Companies is a subject requiring the most careful consideration. Many of us believe that the existence of such Companies is a danger to the profession. Many others of us feel that the profession should not, as a whole, dictate the manner in which the individual members thereof should conduct their business, but should confine itself to exacting an equally high standard from all. The question is full of difficulties; there are wide divergencies of opinion, and each side should give credit to the other for possessing as high ideals of professional morality as the other side, and no action should certainly be taken by the National Body on this subject without allowing full opportunity for the views on both sides to be heard. It will, however, probably be generally admitted by the profession that whatever attitude may be adopted toward these Companies, the individual Accountants who may be identified therewith are brother professionals, equally worthy of trust and confidence with other members of the profession who prefer to practice as

individuals rather than as the officials of a Company.

These are only a few of the matters affecting the profession in National, as distinct from State matters, and they are all of such a nature that no single State Society can successfully deal with them. But I would add to these claims of the National Society that of the economy in time and money resulting from united action on all matters in which the various Societies have common interests. On other matters, peculiar to individual States, while the National Body is ready with its advice at any time, it does not seek to interfere; and in fact, local self-government on State matters by State Societies is one of its fundamental principles.

Such a body the Federation is to-day, and such it will remain in ever growing strength for the benefit of our great profession so long as it is loyally supported by its constituent Societies. Those Societies which are now its members will in the days to come feel proud that through their exertions and their loyal support in the days of its infancy, they have built up a splendid National Organization on democratic lines—one in which the interests of all sections of the profession throughout the country are duly safeguarded and in which no one section, however important, is allowed to dominate its councils.

PUBLICITY.

ADDRESS DELIVERED BEFORE THE ILLINOIS BANKERS' ASSOCIATION BY SEYMOUR WALTON, A.B., C.P.A., REPRESENTING THE ILLINOIS SOCIETY OF CERTIFIED PUBLIC ACCOUNTANTS.

In one of his messages to Congress, our worthy president has said that one of the safeguards to be furnished the public in its dealings with the large aggregations of capital is publicity, but he did not state what kind of publicity he referred to. There is no doubt that he was entirely correct, if he meant the furnishing to the public of the broadest and most comprehensive knowledge possible, of all the circumstances dependent upon the organization and the subsequent management of any corporation whose stock is offered for sale on the exchanges of the country. But if the publicity comprises only the publication of a mass of figures that no one can understand, and does not deal with the manner in which these figures are made up, no possible good can result, while much harm may be done by deluding the public through a false show of fairness and square dealing.

Recent developments in regard to some of our most important combinations of capital have called the attention of the general public to a condition that has been well

known to bankers and brokers. It is the most vicious characteristic of our financial life and is none the less to be deprecated because it is universal, not only in this country but in England. The only place in which it is not tolerated even in a slight degree is in the incorporated bank, and for that reason it would seem that the bankers of the country were the proper ones to appeal to in order to rid ourselves of it.

It is hardly necessary to say that the objectionable practice referred to is the overcapitalization of incorporated companies, in other words, the watering of stock. While we see a great deal in the daily papers about this practice, it is doubtful whether very many business men really know much about it, and it is certain that the widows and orphans who are sometimes persuaded to invest in stocks dealt in by reputable dealers are absolutely ignorant of the matter, or, if they have some inkling of it, have no idea of the extent to which it is carried.

It does not seem necessary that we should have to live in Utopia before we can bring about a state of affairs in the business world where the absolute truth shall be known about the corporations whose stock is offered to those ignorant of the wiles of the promoter and the stock jobber. There are two classes of men who can aid in bringing about such a consummation, the banker and the accountant. At present they are both sometimes used, innocently enough, perhaps, to pull other men's chestnuts out of the fire. The banker is taught to look at the earning power of a stock as a correct measure of its true value, and as long as dividends are paid regularly, he is apt to care little as to the solid foundation of assets on which the company may or may not be based. The fact that the plant account may be inflated to the point of bursting by the water that has been pumped into it to make it balance against the capital account is apt to be immaterial to him, provided there is a reasonable certainty of the periodic receipt of the usual dividend. He does not stop to realize that he never values the stock of his own or of another's bank in the same way. No banker would buy or recommend the stock of a bank solely on its earning power. He must be persuaded that every dollar of assets represented in the left-hand column of the balance sheet is not only actually present but that it is worth all it pretends to be. There is no toleration of water there. The first question asked about a bank, concerns the real value of its assets. If that question can be answered satisfactorily, the stock is worth its book value. The earning power then adds a little to the market value, but only a little in comparison with the total value.

The law safeguards the investor in bank

stock by demanding the absolute truth in the statements made to the public. The banker should in his turn demand from the law that the same truthfulness should be exacted from the ordinary corporation. There is a radical difference, however, in the data making up the statement of a bank and that of the usual corporation. In the bank the assets are certain, definite items, whose value is readily ascertainable, only two of which are susceptible to error, intentional or otherwise. These are the Stocks and Bonds and the Bills Receivable. They may both be overvalued by officers who are of too sanguine a disposition or who may wish to give the stock a fictitious value in the eyes of investors or depositors. This overvaluation is easily detected by the bank examiners and is not usually indulged in by any but the most reckless class of bankers, whose general reputation is usually sufficient to warn the public against trusting too implicitly to their statements. Of course, we are not now considering cases of deliberate falsification for the purpose of concealing a defalcation.

In the usual manufacturing, trading or public utility corporation we find a very different state of affairs. The original cost of the plant is not known to the public and the figures representing it in the statement may be inflated to a relatively erroneous amount, without detection. Those who are on the inside know that this is almost universally the case. At the best, the cost of the plant represents in full the bonds outstanding, leaving the capital stock no representation whatever, except the hypothetical value of the franchise or good will. In many cases it is necessary to supplement the actual value of the real assets with a portion of the supposed value of the franchise in order to cover the bonds issued at a discount.

The stocks and bonds thus created are placed on the market accompanied by a statement showing an inflated value of plant, but with no hint to the confiding investor that it is not the actual cash value. The bonds are sold to build and equip the plant and the stock is taken by the promoters as clear profit, to be sold for whatever they can make the public believe it is worth, based on its present and prospective earning power. If the actual truth were known regarding it by the investing public, there is no doubt that the sale would be very small and would be confined to the speculating element, over whose losses we need shed no tears; while the confiding investor of hard-earned savings, the widow seeking profitable employment for her insurance money and the trustee of minor children would be protected from losses that might often mean dire distress.

Not only do these remarks apply to the figures representing the inception of many companies, they are often applicable to those representing the operating results. Tables are prepared showing the operating profits and expense that are entirely misleading because made up on a wrong basis. They may be signed by officers who are honestly convinced that they are correct and who will defend them against criticism. There are so many ways in which men can deceive themselves and incidentally the public that only a few can be enumerated here. Charging to plant account what should go to replacement or repairs is one of the most common. It is sometimes a difficult matter to determine the classification of items that are near the line, and the temptation is often very strong to take the benefit of the doubt and charge them to plant account.

Another error is to credit to operating profit items that are sporadic and do not arise from the regular and continuous operation of the business. As an instance of this may be mentioned a case in which \$50,000 was made at one time by a purchase of the company's stock at a discount of 50 per cent. As this was an exceptional transaction it was in no sense an operating profit, yet the secretary of the company included it in his statement of the operations, submitted to intending purchasers, and was very much incensed when the accountant took it out of that category and put it in as a reduction of the plant account, which it really was, since the plant account had been more than doubled to offset the water in the stock.

A year afterward, when this company offered an issue of bonds to the public, a circular was sent out signed by a banking firm of the highest respectability, giving the figures of the operating net profits for two years as \$81,000, when as a matter of fact there were only \$19,000, as judged by the accountant referred to. The bankers had accepted the figures furnished them by the company, without any attempt to verify them except, perhaps, by sending an ordinary bookkeeper to see that they were correctly taken from the books. They did not seem to care whether the books were correctly kept or not.

Instances might be multiplied to almost any extent showing how it is possible to make statements which are mechanically accurate and which are true transcripts of the books, and yet which are absolutely false and misleading.

Having shown the conditions as they exist, the question arises as to the proper remedy to be applied. The only one, or at least the most effective one, is the right kind of publicity. We have seen that the statements of the officers are not to be depended

upon, even when they are honest. The Federation of Societies of Public Accountants has proposed the remedy to the Secretary of Commerce in connection with the examinations to be carried on by his department. It is to employ Certified Public Accountants to make the examinations and certify to the facts. The Certified Public Accountant is eminently fitted to do this work. The fact that he is certified by his State presupposes a long and varied experience or a definite training fitting him to pass the rigid examination required for the degree. This training is not simply in knowledge of figures and accurate bookkeeping. It includes such matters as the proper taking of inventories, the correct classification of operating income and expenses, the distinction between construction, which is an investment, and operating outgo, which is an expense, in short, a thorough knowledge of all phases of a business and of the way to make his knowledge effective in giving out a statement which may be easily understood and which will give the intending investor a true and reliable indication of the condition of the company. If it is acknowledged that he is able to afford this information, it must be granted that he is the best man to do it, because he is absolutely independent, and because he has a reputation for fair and honest dealing to uphold. He never allows himself to be made the advocate of his client. His function is to ascertain the truth and to publish it without fear or favor, for to do otherwise would be to deprive himself of his most valued asset, his reputation for honesty and sterling integrity.

The statements required from corporations should not be the formal ones now sometimes published, but should go into the origin of all asset accounts with a view to determining whether they actually represent value or have been inflated to meet the requirements of a well watered stock account. If anything is carried as an asset in the nature of good will it should be plainly so stated. Patents should be put in at not more than cost unless the value is distinctly stated to be an estimate, and in general all assets should be stated to be at cash value or at estimated worth.

Such a statement, certified to by an accountant of standing, would be of great value not only to the proposed investor, but also to the old stockholder who is anxious to know what care is being taken of the money he has intrusted to the officers of the company. It would tend, more than anything else could, to weed out companies whose stock really represents nothing but prospects, or at least would serve to notify those who invested in them, that they were taking chances on the future and

were not buying anything of present value.

The State of Massachusetts has taken a step in the right direction by the enactment of a law last winter requiring all companies with a capital of \$100,000 or more to file with the Secretary of the Commonwealth a statement of its Assets and Liabilities, in which the valuations placed on Patent-Rights, Trade-Marks and Good Will are separately enumerated. This statement must be signed by the officers and directors of the company and must be certified to by an outside auditor, who must make oath that he has examined the books and verified the statement. The law applies not only to local companies, but also to those whose head office is outside of the State, but who do business within its borders.

We hear a great deal nowadays about trusts and the necessity for their regulation by some form of legislation. The difficulty that confronts those who are honestly anxious to regulate the evil without destroying the good, is the almost impossible task of framing a law that will discriminate between them. It is a well-known fact that the principal reason for the organization of the trusts that have proven to be vicious is the desire to manufacture stock that can be sold to the public. If the proper statement were to be made of the assets turned over by the underlying companies, of the bonds issued against them, of the amount of stock presented to the manipulators and of the real value of the stock offered for sale to the public, it needs no argument to show that there would be no market for such securities and therefore no temptation to manufacture them. No sane man would have paid 130 for Amalgamated Copper if it had been known that of its 75 millions of capital 36 millions were a deliberate steal on the part of the men who were managing the deal. If the public who invested in this inflated stock, or the bankers who are often called upon to advise the public, had demanded a proper statement from reputable accountants in no ways affiliated with the company, there is no doubt that sufficient facts would have been disclosed to have prevented anyone from falling into the trap so adroitly laid for the unsuspecting.

There are numbers of schemes differing from Amalgamated Copper in degree rather than in kind that are offered to the public and frequently recommended by bankers, whose essential weakness would be exposed by the investigation into their origin by properly qualified accountants. In this connection some timely words by that veteran of finance, Henry Clews, are worthy of close attention. He says: "Many of these industrial combinations have been organized in disregard and defiance of legit-

imate finance, and have exposed the stock markets and all the monetary interests depending upon them to risks and disastrous disturbances inseparable from organizations whose foundations rest largely on wind and water, and on the prospectuses and book-keeping that often fail to tell the truth, the whole truth and nothing but the truth."

The bankers of the country are vitally interested in this subject, for no one is more nearly concerned with safeguarding the investment of the public than the guardians of the public's money. As a class they have been pre-eminently true to the trusts reposed in them and to all their duties as public-spirited citizens. There is no doubt but that they will take up this new question and solve it with equal fidelity, if they once become satisfied that a proper solution can be obtained.

To that end the Illinois Society of Certified Public Accountants invites the bankers of the State to a closer study of the profession of accountancy, in order that they may know what an accountant is, and that they may more thoroughly understand the nature and value of his services. When that knowledge has been obtained, we are sure they will join hands with us in an earnest endeavor to place the business of the country on a more solid and permanent basis, possibly to the extent of completely eliminating the false statement from circulars and other publications that now so often mislead the investing public.

MODERN BUSINESS AND THE ACCOUNTANT.

ADDRESS BEFORE THE CONGRESS OF ACCOUNTANTS BY THE CHAIRMAN, J. E. STERRETT, C.P.A.

After speaking of the way in which the idea of the Congress was inaugurated and carried out, and welcoming the representatives of foreign societies, Mr. Sterrett continued:

Coming together to-day in this, the first International Congress of Public Accountants, it may not be amiss to pause for a moment to inquire into the causes that have produced this profession to which we are devoting our lives and concerning whose future growth and development we are earnestly to confer.

The increase of wealth during the nineteenth century, and particularly during its latter half, marks an epoch in the world's history. I am speaking now of the wealth of the community or of the nation, not of the individual. Nor am I referring merely to those forms of wealth, such as gold, silver, notes of hand or other tangible evidences of wealth that we are wont to associate with the strong box or the more modern safe deposit vault. Rather would

I bring to your thought those innumerable manifestations of human activity which contribute to the physical, intellectual and moral well-being of civilized man and particularly to our fellows, somewhat indefinitely comprised under the race title of Anglo-Saxon.

This remarkable increase in wealth has had a notable effect upon social life. The masses are becoming more educated. Even the poorest can secure the benefits of the modern newspaper—that wonderful searcher out of the ends of the earth which brings the affairs of the nations to our breakfast table. People are better housed. Cheap transportation makes possible such a combination of city and country as was never known before. Instance after instance could be cited of how this increase of wealth has, as with a magic wand, touched the homes and lives of the humble, to uplift and transform them.

Its effect is even more marked in the realm of business. In the days of Queen Elizabeth, when the English nation was experiencing almost a new birth, the income of the kingdom was some two and a half millions of dollars per year. These were times of great prosperity, a high tide was in and the nation was flourishing as never before. To-day this sum represents the volume of financial transactions of a grocery house enjoying a fair jobbing trade. A department store in any large center of population would handle such an amount of funds in a few short months. While, when compared with the income of any one of a large number of our railway or industrial corporations, or with the greater municipalities, the amount once so great fades almost into insignificance.

An essential feature of this modern phenomenon of business is that it is not individual. We have many men of large accumulations, it is true, but we find an immense army possessed of means which in themselves are of little moment, but which united form a vast stream of wealth. It is from this commingled yet ever separable fund that the life blood of business is drawn. From this source springs the financial strength of modern business institutions.

But wealth is inanimate. It will not of itself go out and sow and reap. It will not increase and multiply in response to mere idle wishing. It must be organized, it must be directed. Hence we find centralization of authority. All forms of wealth are being brought more and more under definite control. We are learning that economic waste is a moral wrong. This control of wealth is bringing about specialization—has already produced it to a large degree. Men are devoting their lives to the mastery in some

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instances of one little process; in other cases they have chosen wider and more varied fields of action.

To meet a necessity arising from this economic development there has been evolved the public accountant. Accounting is a vital element of business, as necessary to its conduct as light is to the eye. The growth of business, both in volume and in the diversity of its ramifications, has created a need for scientific accounting methods upon the one hand, and the intelligent, conscientious oversight and supervision of fiscal operations upon the other. To meet these needs is the studious function of the public accountant. Nor is his field narrow or circumscribed.

That the public accountant is a sort of detective, whose chief service is to show how a thief tapped the till, is a conception of our work that is altogether inadequate. It is true that trusted officials and employes at times betray the confidence reposed in them and that when such occasions arise it is a part of our duty to turn a searchlight upon their nefarious conduct. Such cases, however, form but a small part of our activities. Prevention is better than cure, and the public accountant serves a larger purpose in the keen, penetrating tests and proofs to which he subjects the books and accounts submitted to him for audit. The keynote of modern business is faith. Men must be trusted, otherwise the wheels of business would cease to revolve, but strict accountability must go hand in hand with faith, else temptation is placed in the path of the weak, virtue is destroyed, and he who is the responsible head of affairs makes of himself a partner in crime.

Important as the safeguarding of funds and the prevention of fraud and error undoubtedly are, a broader and still more attractive field has been opened to us. Men responsible for the conduct of large enterprises to-day require not *history* but *news*. It is of little avail to find out three or six months afterward that last year's business was conducted at a loss. It is needful that the loss be discovered as soon as it begins, and also that the reason for its occurrence be revealed in order that it may if possible be overcome or removed.

It is one of the chief functions of the public accountant so to marshal the accounts that they will set forth the facts essential to the proper management of a given enterprise, and this in a form easily understood and with such promptness that the information is current with the transactions described. Business administration cannot for any length of time achieve its best results unless supported by an accurate, detailed and constant knowledge of condition as to assets, liabilities, costs, expenses and income.

This knowledge is obtainable only by the maintenance of a properly devised accounting system.

The public accountant touches business life upon every side. His client may be the governing body of a city, state or nation, or he may be engaged by the owner of a corner grocery store. His attention may be required one moment by a great corporation, the next he may be preparing the basis for an equitable settlement between partners who are no longer willing to work in double harness. The lawyer dealing, as he so often does, with problems relating to accounts or business practice, the tradesman, the manufacturer, the financier, all alike have their needs that can be supplied only by the knowledge, skill and experience possessed by the public accountant.

To quote from a recent paper from the pen of Mr. A. Lowes Dickinson, whose standing as an accountant entitles his words to thoughtful consideration: "A public accountant is not merely a bookkeeper, a statistician or a man of figures, nor only a good man of business, but if he is successful in his profession he must combine all these qualifications and in addition have a general knowledge of all industrial undertakings, of the forms of accounting most suitable to each, and of the general principles both legal and economical which govern them."

That here is a calling appealing to talent of no mean order is evident. That these requirements, comprehensive and almost impossible as they may at first blush seem, are to some reasonable extent being fulfilled is proven by the increasing degree of confidence that men of affairs are reposing in the members of this young profession. The public accountant is being invited to a seat at the council board and his suggestions and recommendations, even in matters that ought not to be considered of a strictly accounting nature, are received with attention and respect.

* * *

To paraphrase a recent political utterance, "a profession is of worth only in so far as it promotes the common interest." By that standard accountancy is to be judged. In our planning, let that principle go before us as a pillar of light. The problems confronting us are many and complex, but putting aside all selfishness may we continue to work for the upbuilding of our profession in a spirit of honesty, of courage and of common sense.

The directors of the Illinois Society of Certified Public Accountants are considering a change of form for THE AUDITOR.

There is a desire in some quarters that it appear in magazine form, but the matter has not yet been decided.

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SOME OF THE TRIALS AND TRIBULATIONS ARISING IN THE WORK OF THE PUBLIC ACCOUNTANT.

Probably nine out of every ten business men will exclaim, on reading the above title, that the public accountant has no trials and tribulations in his work, but that, on the contrary, they cannot imagine any other line of work so free from the little cares and vexations that plentifully beset the path of the mercantile man.

Let us consider some of the cases which the accountant is likely to run up against in the conduct of ordinary audits.

The one which seems naturally to come first to one's mind is that of the old bookkeeper, who has been, say, nearly thirty years in the same place. It is almost a certainty that he will regard an audit of his books in the light of a personal insult and will inveigh against his employer for having any suspicion of him after so many years' faithful service, and it is therefore with no feeling of joy that he greets the arrival of the accountant. Indeed, on one occasion an old bookkeeper put on his coat and stated his determination to quit then and there if his books were audited, until his employer talked with him and smoothed the matter over. During the progress of the audit it will most probably develop that, owing to the rapid growth of the business, the methods in use are very antiquated and need considerable revision to bring them up to date. Now come the accountant's trials; let him suggest this fact to the bookkeeper with the greatest tact at his command, and what is generally the result? Antagonism on the part of the bookkeeper to everything suggested, and when one comes to analyze the situation it is not difficult to see why. The bookkeeper for thirty years has been in a rut, keeping his books in a certain way, and is wedded to it, and he also knows in his heart (and here comes the real point) that he can only keep them in that way and that he is now too old to adopt other and newer methods. It may be said in reply that this need not worry the accountant; all his duty calls him to do is to send in his report of suggested changes, and there his responsibility ends. That may be so, but what is the result? The accountant has now put the onus on his client, who has either to discharge a good and faithful servant or continue in the old way. Is it not rather the duty of the accountant, however much patience and tact it may require, to endeavor to override the bookkeeper's objections and to teach him, little by little, how to put in newer methods? It may be that this cannot be all accomplished at one audit, but in successive ones it can.

Then there is the bookkeeper with a tale

of woe, which he is continually pouring into the ears of the accountant, the tale consisting nearly always of how hard he has to work and how poorly compensated he is. The bookkeeper should stop and consider for a moment that the accountant has no interest in what is, after all, a strictly personal matter, and that the accountant is only concerned in the work of the bookkeeper. Some even go so far as to ask the accountant to say a good word for them to their employer, of course, with the view of obtaining a higher salary, forgetting that if he did this the accountant would lay himself open to be told that the matter did not come within the scope of his duties, and also that the employer is just as likely to take an adverse view of such a recommendation as a favorable one. Such a bookkeeper as this will require the exercise of considerable tact and patience by the accountant.

Some clients, moreover, can almost be classed as trials and tribulations by the accountant, for who has not come across the client who comes around every few minutes to know how you are getting on and asks questions as to why you do such and such a thing and whether you are going to do this or that? Such a client calls for the exercise of the greatest tact on the part of the accountant.

The foregoing remarks affect almost entirely the accountant doing the actual work of the audit, but there is another client whom the accountant will meet with at some time during his career. It is the client who wants the statements accompanying the report prepared in his way. It may be that his request is a reasonable one and that the alterations he may desire are of such a character as not to affect the general results or cause any misleading conclusions to be drawn from the figures, but, on the other hand, it sometimes happens that the accountant is asked to so change the form of the statements as to convey an erroneous impression.

It is here that the certified public accountant should remember the dignity of his profession and be firm in his refusal to amend the statements in any way which would render them incorrect or misleading. It is, of course, known that some accountants in their reports state that the figures they submit are correct only "according to the books," and the presumption is obvious that by so doing the accountants consider that they are taking no responsibility as to them beyond the mere clerical accuracy. But of what little worth are such figures to the firm whose books have been audited and of what value to the general public is a balance sheet certified to as being correct "according to the books?"

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IN MARYLAND.

Down in Maryland it is becoming the fashion for chief bookkeepers and auditors of corporations to fit themselves for the examinations required for the C. P. A. degree, in order to increase their usefulness to their employers and to have settled for all time the questions of their fitness and qualifications.

The purposes of these gentlemen are altogether laudable, and we hope they may succeed in their ambition, but when they go up against a stiff examination we fear they will sadly miss some of the information gained only in the school of experience.

No one counting house can fit a man for the profession of public accountancy, as these gentlemen will learn. However, we will await results and save our comments.

GEORGE WILKINSON.

The reports of the Congress of Accountants at St. Louis show that a loving cup was presented to Mr. George Wilkinson, in recognition of his services to the profession as secretary of the Federation, from which office he retired, owing to the by-laws limiting the term of office to one year. The presentation of this cup was a timely act, but it did not begin to express the appreciation of the accounting fraternity for the great service Mr. Wilkinson has performed in its behalf.

During his incumbency of the office no task has been too great, nor has his own convenience ever been consulted. If anything needed doing for the Federation, George Wilkinson did it, and his fellow accountants will ever hold for him a warm spot in their grateful hearts.

A. LOWES DICKINSON.

Mr. A. Lowes Dickinson recently passed through Chicago on his way to the coast, and while here was called upon by a number of the members of the Illinois Society.

The society is proud of Mr. Dickinson, and gratified that the Federation has chosen him for its president.

He seems determined to accomplish everything possible in behalf of the profession while he is in office, and all who know him are sure he will be a great success in that position. We only regret that Mr. Dickinson finds it necessary to be away from Chicago such a large part of his time.

MEETING.

The Illinois Society of Certified Public Accountants will hold its regular quarterly meeting at room 314 Royal Insurance building on November 26 at 2 o'clock p. m. It is hoped that all members will be present, inasmuch as it is intended to discuss some very live questions affecting the profession.

These discussions will be led by members chosen by the president, and after the subject has been opened all the members will be given an opportunity to be heard.

A number of accountants not members of the society have been invited to attend the meeting and it is expected that a thoroughly enjoyable session will be held.

NEW C. P. A.'S.

The following have been granted the degree of C. P. A. since our last report:

William J. Bonner.

William Kendall.

James King.

Gordon H. Somers.

Rudolph Speth.

Morgan G. Wake.

Horace Waters.

Francis F. White.

We are informed that only five applications now remain undisposed of.

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Articles appearing in THE AUDITOR are not to be read as having received the endorsement of the society, but are to be taken as individual expressions of opinion, and as such may be answered in future issues. The Editor invites contributions from all Accountants.

ANNOUNCEMENT.

At a meeting of the Directors of the Illinois Society of Certified Public Accountants, held on December 10th, it was decided that, beginning with the January number, THE AUDITOR will appear in magazine form. This change will afford opportunities for improvements, not feasible in the present form, and make THE AUDITOR what it was intended from the beginning it should be—the leading journal of the United States devoted solely to the interests of Public Accountants. While THE AUDITOR owes its existence to the Illinois Society of Certified Public Accountants, that organization is quite willing that it should represent the interests of all Public Accountants, everywhere, and to the end that it may most successfully attain its objects, the co-operation and support of every Public Accountant in the United States are solicited. The recognition of accountancy as one of the learned professions, by the American public, can be obtained only through the efforts of Accountants themselves, so we feel that, since our labors are directed to this end, we are entitled to receive from every member of the profession his cordial support in the efforts we are making.

The daily press records the entry of a judgment in the courts of New York, in favor of the stockholders and against a director of the American Malting Company, amounting to over a million dollars. The contention upon which this judgment was entered was that the directors of this com-

pany had been guilty of the payment of dividends from the capital without regard to the sufficiency of the earnings to meet dividend requirements. The American Malting Company is one of those industrial combinations or consolidations, which were floated during the halcyon days of 1897, when the American public was in a humor to buy anything offered to it, regardless of actual values. To keep the company in apparent good standing, the directors found it necessary to pay the accruing dividends on the preferred stock, and the earnings being insufficient for the purpose, they did not hesitate to invade the capital. The court in this case holds that directors guilty of such a flagrant offense against financial decency, are individually responsible to the stockholders and the company for the amounts so wrongfully paid. No one, aside from the offending directors, will consider the decision of the court improper. There will be practically universal agreement that the decision is just and timely. But consideration of this matter should not end with a mere endorsement of the court's action. The matter is of far-reaching importance and should serve to arouse public opinion to the necessity for a complete exhibit of the affairs of these large corporations to their stockholders, at least as frequently as once a year. At each annual meeting the stockholders should elect a competent auditor, wholly disinterested and independent, to audit the affairs of the corporation and mail to each stockholder a certified statement, showing its condition as to assets, liabilities, gains or losses. If this were done, and it was shown that dividends were paid from capital, it is safe to say that the stockholders would promptly retire the directors giving consent to such action. There is a crying necessity for the protection of stockholders, both present and prospective, from the actions of directors more concerned with speculation in the securities of the corporation, than in so managing its affairs as to conserve its assets and increase its earnings. The various stock exchanges of the United States should decline to list the securities of any corporation, until a statement of its condition, attested by a public accountant, has been presented, and thereafter should exact statements from time to time, similarly attested, which should fully show every fact essential to the formation of correct con-

clusions as to the standing of the corporation and the value of its securities. These statements should be promptly made public, since the public, being indirectly solicited to purchase these securities, has a perfect right to full information. A stock exchange exists for the sole purpose of accelerating the sale of securities, and it owes a duty to those who patronize it, to protect them to the fullest extent. There can be no doubt of the ability of the stock exchanges to successfully put into effect a rule of this character. The banks should also decline to accept as collateral for loans the securities of any corporation unless statements of its condition, certified by accountants of good standing, are forthcoming at regular periods. Conservatively managed banks would welcome an innovation of this character, and those not conservatively managed would hardly care to make themselves conspicuous by their opposition. It is a fact that the greatest power in the United States is reposed in its banking institutions. Taken collectively, they represent financially all that the American people have accomplished. They also represent the possibilities of future business progress, through their ability to control the working capital of the country. They have within them the power to compel the observance on the part of the business community of correct business practices and principles, and if they fail to exercise this power and put a stop to a vast deal of the fraud and chicanery that succeed through the medium of "securities," conceived in secrecy, and born and brought up in mystery, they deserve to be themselves looked upon with suspicion. But this brings us up to the subject of "the banker who speculates," and that, as Kipling says, "is another story," and we will take it up another day.

The University of Illinois is considering the establishment of a school in Chicago wherein will be taught those branches necessary to fit young men for the profession of public accountancy. The authorities of the University, as an aid in their consideration of the subject, have asked for the opinions of several well-known accountants, and by this time have no doubt received expressions from those addressed. So far as we are informed, the sentiment of the accountants is favorable to the idea, and they will cheerfully assist in making such a

school a success. Judging from the wording of the letter sent out by the University to the accountants, the authorities are contemplating plans of a broad character, which, if put into effect, will result in giving Illinois facilities for educating accountants second to none in the world. It should be a matter of pride and gratification to the holders of certificates granted by our own University that it is to be a pioneer among institutions of learning in recognizing accountancy as one of the learned professions. There has been discernible in recent years a disposition on the part of our universities to align themselves with the tendencies of the times, and arrange curriculums to meet the demands of everyday life. This disposition is most gratifying, since it operates to popularize higher education among those who have heretofore been inclined to regard it as of doubtful value. The old idea that a college education meant chiefly a few years spent in learning to read the works of the long since deceased litterateurs of Greece and Rome, has been dispelled by the colleges themselves. When we see them turning out machinists who are capable of serving as superintendents at the age of twenty-one, and farmers who, before they have sprouted whiskers, can go home and show their fathers how to double the yield of the fields, we must confess that their utility can no longer be questioned. The nearer the colleges get to the plain people the better for both. There is no better promise for the future of America and American manhood than is to be found in the growing popularity of the colleges with the masses, and every man who loves his country and its people will do what he can to increase this feeling.

It will be seen by reference to a list of defalcations reported by the daily press since our last issue, and published elsewhere in this number of THE AUDITOR, that the familiar offense of embezzlement has by no means been eliminated from our business life. The figures given are appalling, reaching as they do to the enormous total of \$1,661,676.91, and it is by no means certain that this amount represents the total of such defalcations, or that we have been able to secure a report of all cases that have been made public. For the purpose of pointing a moral, however, the cases cited are quite sufficient. Indeed, a large number of morals could be pointed from the material at hand. What most attracts the attention, perhaps, is the previous high standing of the accused. If one stops to consider the matter, however, it is quite apparent that important embezzlements can be committed only by those occupying places of trust and confidence. People who are

not trusted are given no opportunity to embezzle. To the published list should be added many more, representing those cases which are not permitted to become public, but of the existence of which professional accountants are quite well aware, it being the practice of many houses to handle embezzlements in their own way, without resort to the machinery of the law. Criminologists are of the opinion that the chief cause of so many embezzlements is to be found in the desire to get rich quickly through the medium of speculation, the embezzler thinking he can temporarily use funds in his custody and replace them out of his winnings. In this connection a whole volume might be written, beginning with the training of the child and the molding of his character, and running through all of the ages of man to the octogenarian who finishes his few remaining years in the darkness of disgrace and misery, shared, perhaps, by grandchildren too young to know what money is. It is not our purpose to touch upon the moral questions involved further than to deplore, in passing, the craze to get rich, which is the most serious existing menace to the moral structure of the American people, and to the future greatness of our country. Our object in collating information concerning current embezzlements is to awaken, if possible, the business community to the frequency with which this crime is committed, and to remind the management of business houses and boards of directors of a double duty owing by them, namely, a duty to protect the funds over which they exercise control from the rapacity of easily tempted employees, and a duty to keep temptation as far as possible from those engaged in their service. To discharge these duties it is necessary that peculation be made as difficult as possible and that concealment of the offense be made as nearly impossible as it may be.

These objects may be accomplished best by having the books of account so laid out that peculation is hard to conceal, and by engaging public accountants to conduct frequent audits of the books.

Many an employe has been kept in the straight and narrow path of honesty by the knowledge that an infraction of the eighth commandment would be followed by quick discovery and certain punishment. The record of a few days' embezzlements, which we have published, is a record also of a failure on the part of those in authority to properly safeguard, not only the funds under their control, but also to safeguard their employes against temptation. An employer has no moral right to place temptation before his employes, whatever his legal rights may be. If the employer insists upon viewing the matter from a purely

utilitarian point of view he will find that it is cheaper to *prevent* than to *endure* embezzlement. In other words, the crime is so common that to fail to take out the insurance against it which frequent auditing affords is as short-sighted as would be failure to insure buildings and merchandise against fire and lightning.

In our last issue we called attention to the conviction of two trusted Bank employes for the embezzlement of \$20,000 and \$90,000, respectively, as reported in the Chicago papers of November 12. Since that date various newspapers report additional defalcations in banks, as follows:

\$10,000 by a Bank President at Matthews, Ind.

\$41,000 by a Bank President at Lima, O.

\$14,000 by a Bank President at Montpelier, O.

\$60,000 by a Bank Cashier at Davenport, Ia.

\$25,000 by the Secretary of a Savings Bank at Lima, O.

\$25,300 by a Bank Cashier at Des Moines, Ia.

\$25,000 by a Bank Cashier at Wapello, Ia.

\$37,120 by a Bank Clerk at Cambridge, O.

\$8,000 by a Bank Teller at Arlington, Tex.

\$75,000 by a Bank Cashier at Newark, O.,

in addition to the sensational closing of a Bank at Oberlin, O., by reason of large loans made by the President, as reported, without any security, and without the knowledge of the Board of Directors.

The large amount of money deposited with the Banks should demand every reasonable precaution on the part of the Directors and Officers, and unless they have periodical Audits of the books by independent Accountants, have they exercised every reasonable precaution?

The examinations made by the National Bank Examiners serve a good purpose, but every Banker knows that the work of these Examiners cannot, in the time at their disposal, be as thorough as would be the audit of a Certified Public Accountant. It will be said that some Banks have in their employ an Auditor whose duty it is to check up his fellow employes, but it has been shown in Chicago very recently that such employe may himself be a defaulter. The principal argument against Auditing by an employe of the Bank, even though he may be fully qualified in other respects, is because it is difficult and almost impossible for him to thoroughly scrutinize the actions of the officers and employes who outrank him on the staff of the Bank, and, of course, his certificate as to the standing of the Bank can carry no weight outside the Bank itself.

The frequent and large misuse of funds by officers and employes of Banks must be

prevented. The remedy at present is in the hands of the Stockholders and Directors, who can insist upon the periodical employment of independent Auditors by the executive officers of the Bank; should they fail to do this voluntarily it undoubtedly will lead to legislation, the compliance with which may be much more difficult.

OUR QUARTERLY MEETING.

On November 26th the regular quarterly meeting of the Illinois Society of Certified Public Accountants was held at the rooms of the Secretary, and, while the attendance was not as good as was hoped for, there was no lack of interest in the matters brought up for discussion.

The attention of the meeting was principally given to a consideration of the following questions:

"What limitations should be observed in advertising?" and

"Should the Courts be asked to consider knowledge gained by an Accountant of his client's affairs, as privileged communications?"

The discussion of the first subject was opened by Mr. C. J. Marr, who was induced to put his informal remarks into writing for reproduction in these columns. Mr. Marr's remarks were as follows:

"Mr. Chairman and Gentlemen:

"I have been asked to open the talk on the subject of 'What limitations should be observed in advertising?' and I may say frankly at the outset that I do not believe in extensive and indiscriminate newspaper advertising. Still less do I believe in sending out circulars broadcast, and least of all in the distribution of calendars, blotting pads and such things, which, of course, are only a step removed from the matchbox and paperweight given away by breweries and certain other lines of business.

"The standard of the profession cannot be maintained by indiscriminate advertising or the scattering of circulars broadcast throughout the country. These methods have a tendency to end in a competitive cutting of rates, and, while they may have proved of advantage to such accountants as have adopted them, it is doubtful and improbable that they would ever influence important work in the direction of the advertisers. After all, the important work will go to the accountants of proved ability and integrity, in whose reputations bankers and others with whom the work originates can have implicit faith.

"It is true such circularizing and advertising have the effect of keeping the advertisers' names before the public, but people who have important work to be done do not refer to newspapers to find the accountants whom they wish to employ. They are

much more likely to refer to their bankers and attorneys for the names of reliable accountants.

"If I (and probably most of you here will feel the same way) were looking for a good doctor for myself or any member of my family, I would shrink from going to one of these doctors whose spend enormous sums of money in showy and specious advertisements, claiming to be able to make the most wonderful cures, and I would hesitate to take any of their patent prescriptions. If I did take one, I would probably hesitate to recommend it seriously to others. On the contrary, if I were in need of a medical adviser in a serious crisis, I would probably call in one who had earned a good reputation as a sound doctor and had built up a substantial practice by hard work and without recourse to advertising or catch-penny methods, and who carried on his practice in the least ostentatious, and shall I say most dignified, way.

"Take the case of the lawyer, also. If I had an important piece of legal business to transact, I would seek out some firm or individual of undoubted standing in the community who had always aimed at high professional ideals, and I would be quite satisfied to leave my business in his hands, but I could never think of going to some lawyer who made it a practice to advertise and guaranteed to successfully prosecute or defend any and every conceivable kind of a case. In fact, do we not all of us in our minds associate a lawyer who advertises with a pettifogger, and do we not all consider most of the doctors who advertise themselves and their patent medicines as humbugs? The point is that if we view in this light such members of the other honorable professions as do advertise, may not others look upon the advertisers in our profession in the same light?

"As a matter of fact, the leaders in the other professions do not advertise and consider it unprofessional to do so, and it would, in my opinion, be a good day for the accounting profession, when advertising came to be frowned upon and the advertiser was looked upon as outside the pale. However, we have not perhaps reached that high standard yet, and the question arises What limitations should be observed in advertising? For my own part, I think a card in a daily paper or a trade paper is permissible, but let it be a simple one, not loudly proclaiming the value of some patent system or patent form of ledger or other device. Mind you, this is on the assumption that because other accountants have taken to advertising very extensively all of us must in self-defense advertise also.

"Then, again, each one of us is continually meeting all sorts and conditions of busi-

ness people in our daily business and social life and in traveling about, of which a good share falls to the lot of the average accountant. One audit leads to another, and one connection extends to several. It is a slow process, but none the less a sure one. In this and other ways numerous opportunities are afforded us of extending our acquaintance and our activities. It has always seemed to me that if an accountant followed up, always within legitimate bounds, the legitimate channels open to him to advertise himself and his business, he would have no need of advertising in the papers. When all is said and done, the best advertisement I ever knew of is to do good work. As I said before, one thing will lead to another and in the end, by reason of thorough and conscientious methods and close attention to a client's interests, any reputable accountant may from small beginnings extend a modest business into an honorable and lucrative practice. Surely there is more credit due to a man who has pushed himself to the front rank by this means than to one who has gone about it on cheap commercial lines, such as by showy advertisements or by going about, as it were, with a brass band to beat up trade, cheapening himself and the profession at the same time. Methods of this sort may get business, but it will not, I contend, get the really good business, that is, the business of the financial houses and corporations and capitalists who have most need of the services of the professional accountant.

"I thank you for having given me your patient attention for a few moments. Until a few moments ago I had not had time to think about how I should address you briefly on a subject of this great importance, but I did not hesitate as to the point of view I should put before you, and this is that it would be better if we did *not* advertise and that other ways are open to us to push ourselves and the profession, which are equally as effective as advertising, if not more so, and involve no sacrifice of professional ideals."

The remarks of Mr. Marr were received with general approbation, and the discussion was participated in by most of those present, a large majority of whom agreed with the position taken by Mr. Marr.

Mr. George Wilkinson being unable to be present, favored the meeting with a communication stating his views on the subjects to be considered by it. His opinion of the advisability of advertising by public accountants was, briefly stated, that it was under most circumstances unadvisable, and seldom, if ever, really profitable.

The next subject discussed was that of "Privileged Communications," it being considered that the facts obtained by a public

accountant relative to the affairs of a client should be held by the courts as privileged communications, not to be revealed by testimony given in litigated matters.

This subject was opened by Mr. John Alexander Cooper, who favored the meeting with a carefully prepared digest of the law as it now stands, with reference to matters held by the courts to be of the nature of privileged communications. Mr. Cooper's remarks, of which, unfortunately, no stenographic report was made, were listened to with rapt attention, and much satisfaction was expressed that he had given the subject such thorough investigation.

As a part of the general discussion of this subject the Secretary read a communication from Mr. George Wilkinson, which we reproduce with much pleasure. The communication is as follows:

"This, in my opinion, is one of the most important matters we have to take up.

Having secured a legal designation, which is now established practically throughout the land, and is becoming better known every day, we should strive to clothe that designation with all the dignity, privileges and protection we can secure.

There seems to me to be three points of view from which it is desirable for us to look at this question:

- (a) The Accountant's.
- (b) The Client's.
- (c) The Public's.

Let us briefly consider these in turn.

(a) *The Accountant's Standpoint.*

For our own sake we ought to secure a state law enacting that all information or knowledge gained by a Certified Public Accountant, either as the result of personal communication from his client, or as the result of his examination of the client's books and affairs, should be given the same protection as confidential communications to lawyers are now given under statute.

This would benefit the C. P. A. by making his services more to be desired than those of an Accountant who is not specifically amenable to state law.

(b) *From the client's standpoint.*—For our clients' sakes the law should protect the information and knowledge of their affairs of which we are the Custodians.

The client can hide nothing from the auditor, however reluctant he may feel to divulge. The minutes of meetings, the most private books, the most sacred papers in the strong box, secret agreements and all are revealed to the Auditor. All these are a sacred trust without protection when once the Accountant is put on the witness stand. At present the only protection we can give our clients lies in a fickleness of memory, which is far from becoming.

(c) *From the public's standpoint.*—The

public would ultimately reap the benefit of legislation that sealed the Accountant's mouth. Men of business—of large affairs—would know that in employing a C. P. A. they could confide fully in him and give him access to the innermost confidences of the business in hand, resting content in the knowledge that the Accountant could under no circumstances be compelled to reveal his confidence.

Therefore we should, in my opinion, seek the enactment of a state law that will protect all three—the Accountant, the Client and the Public—a law that will *cut both ways*; that, while giving protection to the C. P. A. while he is on the witness stand, will seal his lips and the lips of his employees, under heavy penalties.

Personally I shall be proud to see the Illinois Society, which has been the pioneer in other useful directions, be the first to introduce such a bill in the State Legislature."

After the transactions of some purely routine business the meeting adjourned.

NOTES OF THE MEETING.

Mr. Ernest Reckitt, who was expected to take a prominent part in the meeting, was unable to be present, owing to his attendance at the bedside of his partner, Mr. John J. Williams who had been attacked by typhoid fever during a professional engagement at San Francisco. We are glad to be able to state that at the time of our going to press, Mr. Williams is reported as having substantially improved, which is good news to his many friends.

The remarks of Mr. J. Porter Joplin, one of the society's delegates to the meeting of the federation, held in Washington, on October 18, were received with much satisfaction, indicating as they did that at an early date we may anticipate that there will be but one representative national organization of public accountants—a consummation devoutly to be wished.

Jones, Caesar, Dickinson, Wilmot & Co. and Price, Waterhouse & Co. announce that they have arranged to extend their practice on the Pacific coast, and for that purpose have opened an office in the Mills building, San Francisco, where their business will be carried on under the management of G. R. Webster, chartered accountant and certified public accountant, and F. G. Phillips, certified public accountant. Mr. Webster has been associated with the firm for many years as a manager, and Mr. Phillips, who was formerly associated with them, has for the past three years been in practice in San Francisco as a public accountant. His business will be continued as part of that of the firm.

APPROPRIATIONS IN RESPECT TO MUNICIPAL ACCOUNTING.

BY ERNEST RECKITT, C. P. A.

Business economy in a municipality demands that after obtaining an approximately accurate knowledge of the anticipated revenues from taxation and other sources applicable to what is generally designated as the city's general fund, a careful estimate of the expenses of each department and institution must be prepared and the apportionment of the city's revenues is then determined after a careful consideration of all of the above data.

It will therefore be conceded that the origin of all accurate appropriations lies in the union of:

(1) Sufficiency of revenues from taxation, and

(2) Correct estimates of expenses.

The lack of one or both of the above requisites is responsible for much inefficient service to the public, for while the granting of an appropriation beyond the requirements of an institution will have the tendency to create extravagance, it is just as true that, in order to secure good service, it is necessary to have available funds to draw upon.

A scientific study or treatment of this subject, such as it deserves, with the object of placing it beyond the sphere of politics and forever lifting it outside of the realm of mere guesswork, would not attempt to separate the child "appropriations" from its parents, "taxation" and "estimates," neither would it divorce "taxation" from its mate "estimates," for each one in this group has a direct influence and effect upon the other. But as it is the work of the political economist to create laws governing taxation, so it is the especial province of the public accountant to deal with "appropriations," and for this latter reason we shall confine our discussion to this part of the subject only.

A peculiarity of the present manner in which the records in respect to appropriations are kept is that while the whole system of municipal accounting is subordinated to their consideration to the great detriment of the accounts which represent assets and liabilities and surplus of revenue over expenses, a corresponding laxity of method is found to exist in the manner in which these appropriation accounts are kept.

The causes which are chiefly responsible for this condition may be summarized as follows:

(1) Indefinite and insufficient instructions and lax use of term used in the charters or statutes regulating the duties of city and county officials.

(2) No appreciation of the distinction existing between the terms "revenues and

expenses" and "receipts and disbursements."

(3) An entire absence of any intelligent distribution of expenses, with the result that the full benefit of past experience cannot be secured in the preparation of estimates for future expenses.

(4) The employment of incompetent clerks.

Before taking up the consideration of the causes listed above, which contribute to the incomplete and often inaccurate condition of the appropriation accounts as found on the records of most municipalities, we will discuss the reasons why so much prominence is given to the appropriation accounts and the changes which should be made to put these accounts in their proper place, so that a balance sheet and statement of revenues and expenses can be prepared at any time from the balances as exhibited on the general ledgers.

As outlined in the papers already read this afternoon, accountancy in its initial stages dealt entirely with transactions affecting cash only, this asset being the most easily perverted into wrong channels.

As, in the course of municipal evolution, it became necessary to apportion the anticipated receipts to various departments, it was natural that the scope of the cash book was enlarged so that it would show the cash balance of each appropriation. In this manner it can be readily seen how the term "appropriation fund" came to be applied, the word "fund" being used in its widest sense as applying to any sum of money held for a specific object; and as the only records kept were those of the treasurer, it can be stated with perhaps some degree of reason and from this point of view, that these unexpended balances were in the nature of funds.

With the creation of the office of comptroller, appointed to act as a safeguard against any misappropriations of funds by the treasurer, it was only natural that the comptroller's first records were patterned after those kept by the treasurer, one being a duplicate of the other, and at first without consideration of anything else, but as a record of the warrants issued on the treasurer, and to determine the amount of cash the treasurer should have on hand in each fund. Thus we find the comptroller not only adopting the term "fund," as applied to appropriations, but confining his bookkeeping to a mere record of cash receipts and disbursements distributed on the ledger among the various appropriations, and to-day we still find the general ledger of a municipality attempts to be first of all a record of funds, and as an afterthought, by a remarkable system of double double entry, some few accounts with assets and liabilities are condescendingly given a place,

but they are made to feel that their presence is more or less of an intrusion. The writer remembers a laborious investigation to verify the outstanding bonded indebtedness of one of the largest cities in the United States, and on account of the fact that the payments made for the redemption of bonds were charged to the interest fund, together with all payments of interest coupons, it will readily be seen that it was more a matter of good fortune than otherwise that in most cases a corresponding entry was made by which their bond account was decreased and the "stock account" (which corresponded in some respects to a capital surplus account) increased. But even so, some entries were overlooked and the writer had the satisfaction of reporting the city's bonded indebtedness at \$5,000 less than it was stated on its books.

When conditions, such as described, can exist, it does not require much penetration to appreciate the fact that no intelligent system of municipal accounting can be based upon records imitated from those which are suitable only for a city treasurer. It is the duty of the comptroller *in the first place* (if it be possible to consider one part of his records as more important than another) to so arrange his methods of bookkeeping that they shall show the assets and liabilities and revenues and expenses, and, *secondly*, to provide for an accurate system of recording the unexpended balances of all appropriations.

Thus, to reform present methods it is necessary to completely change the old order of things, for it is impossible to combine a system which places accounts with appropriations as its foundation with any attempt to record in proper manner the entries affecting the asset and liability accounts. By a reversal of these conditions, not only can a statement of the city's assets and liabilities and revenues and expenses be prepared from the balances contained in the general ledger, but the condition of each appropriation can be arrived at.

Before entering upon a description of the methods to be employed to give these results, a few words on the subject as to whether an appropriation is a fund or not may assist in a proper appreciation of the manner in which it will be proposed to record same on the comptroller's books of account.

We have stated earlier in this paper that from the standpoint of the treasurer there may be some reason for his regarding the unexpended balance of an appropriation as a fund, for while he does not keep in separate bank accounts the balances of each appropriation, he exceeds his authority if, perchance, he pays a warrant drawn on one

appropriation out of cash belonging to another.

It will be conceded that the status of an appropriation differs totally from that of a trust fund, sinking fund, interest fund or city fund, these latter being creations of the state law, and the city council having no power to transfer the balances of one such fund to that of another. On the other hand, the distribution for specific purposes of the revenues of what we may term the city's general fund, and which are termed appropriations, are determined upon by the city council, in addition to which the laws of many states allow the same body by a majority vote to amend such distribution, as may be deemed advisable.

We therefore contend that the term "fund," as applied to appropriations, is a misnomer, and its use in the past has been unfortunate, as it has had the tendency to place the accounts with appropriations on the same footing as that of trust funds, sinking funds, etc., which are bona fide funds.

Having established the distinction between an appropriation account and a fund, and realizing that there is no special sanctity about an appropriation that would necessitate the whole system of accounts to be subordinated thereto, we may pass on to a consideration of the place that it should occupy in any broad scheme of municipal accounting.

The scope of this paper will not admit of any elaborate description of the details by which appropriation accounts should be kept, but the essentials may be stated to be as follows:

1. That no expenditure involving an addition to the city's permanent assets, which is to be met by payment out of the general fund, should be undertaken without any especial appropriation being made therefor. Thus, it is a mistake to make an especial appropriation for a fire department to cover not only the operating expenses but the erection of buildings and purchase of fire engines. An appropriation must be made for each classification of additions to permanent assets, and the necessity for this will develop in the following paragraphs.

2. No appropriation account should be kept on the general ledger, but a separate account should be kept to record the expenditures of each appropriation. The effect of this plan will be that until the close of the fiscal year the balance of the general fund will represent the net revenues applicable to same and the ledger balances will in all cases represent either assets or liabilities, revenues or expenses, in a similar manner to the ledger balances of any mercantile or commercial concern.

3. An appropriation ledger and journal

should be kept and an account with each appropriation opened, each account to be credited with its respective appropriation and charged each month with the total of the expenditures applicable to same, such charge being the total of the month's entries in the corresponding account in the general ledger.

4. The appropriation ledger, in order to balance within itself, should carry a "general appropriation" account, which would be charged with the total appropriations and credited by the total monthly expenses.

In order to verify that the appropriation ledger is in accord with the general ledger, it will be necessary to deduct the total of all the expense accounts in the general ledger from the balance of the general fund account. The balance thus arrived at would, if no errors had been made in the clerical work, equal the balances in the aggregate as contained in appropriation record.

This method of proof is based upon the reasonable assumption that the total revenues credited to the general fund account had been apportioned, any balance left in the general fund being carried to the contingent fund, this latter being treated as an appropriation in the appropriation ledger.

5. At the close of the fiscal year the expenditure accounts on the general ledger representing additions to the permanent assets should be transferred to the parent accounts in the general ledger, so as to arrive at the total investment up to that date. Such a transfer from an account kept under that part of the ledger dealing with cash or operating assets to that part of the ledger dealing with the city's investment accounts will also necessitate a corresponding credit to the capital surplus and a charge to the general fund.

6. The ruling of the appropriation ledger should be so arranged as to also record the total of all warrants issued on the treasurer applicable to each appropriation, the plan as outlined in the foregoing paragraphs being based on the assumption that every bill immediately it has been duly approved, shall be entered on the records and charged against its appropriation, irrespective of the time of payment.

By the adoption of these columns in the appropriation ledger, one for expenditures and the other for warrants on the treasurer, a connecting link is established between the records, as kept by the comptroller with those kept by the treasurer, which will be found of value in more ways than one.

In addition to the foregoing columns, provision should be made for the suitable recording of all contracts and requisitions chargeable against appropriations.

Having briefly touched upon some of the essential features necessary to reorganize the prevalent methods affecting this subject, we come to a consideration of the four causes enumerated earlier in this paper, which militate not only against any system of recording appropriations, but also against many other branches of municipal accounting.

(1) Indefinite and insufficient instructions and lax use of terms used in the charters or statutes regulating the duties of city and county officials.

The writer was recently called upon to refer to the law governing the duties of a county comptroller in the state of Illinois, and while this particular law may differ from that of other states, it is probable that it may be taken as a general type of all.

Thus, as an instance of laxity in expression, we find that it is the duty of the comptroller to keep an accurate record of "receipts and expenditures," leaving it extremely vague as to whether it intended to say "receipts and disbursements" or "revenues and expenses."

As an example of insufficient regulations, the law allows a comptroller to so keep his books that no liabilities are recorded except at the close of the fiscal year. The laws, as they now stand, may have been sufficient for the requirements of an agricultural community, but are certainly unfitted for present needs, and it would appear to be the especial duty of the public accountant to assist our lawmakers in a clearer understanding of the terms and regulations which should be incorporated into these statutes.

(2) No appreciation of the distinction existing between the terms "revenues and expenses" and "receipts and disbursements."

This subject has been already amply discussed in other papers read, so no further comment is necessary.

(3) An entire absence of any intelligent distribution of expenditures.

It is not sufficient that the total of the expenditures against each appropriation should be known. In order to prepare estimates for future appropriations, a complete classification of the expenditures of each appropriation should be readily obtainable, for the conditions of one year may not be applicable to those of the next year. The general ledger should not be burdened with the details of this analysis, but independent records kept for this purpose, the accuracy of which would be verified as to totals through the controlling accounts of the general ledger.

(4) The employment of incompetent clerks.

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pable accountants can be brought to naught by incompetent clerks, and no lasting improvement in municipal accounting can be effected without a corresponding improvement in the intelligence and morale of the men who have the duty of carrying out the methods inaugurated. It is therefore a misfortune that the prospects offered by a clerkship in a municipal government are not equal to those offered in other lines of work, hence these positions are not usually attractive to bright and energetic young men.

In a naval squadron ordered to act as a unit, it is the slowest vessel that sets the pace, and in like manner, the public accountant's capabilities are limited by the intelligence of those who have to work under his instructions. Our profession therefore demands a combined effort not only to improve the present methods of municipal accounting, but by whatever means we have in our power, to encourage and foster higher ideals and greater intelligence among those whom we depend upon for the results. Otherwise, our labor will have been in vain.

THE LIABILITY INCURRED BY TRUST COMPANIES BY REASON OF REPRESENTATIONS IN THE OFFERING OF SECURITIES TO THE PUBLIC.

BY EDWARD W. HARRIS, OF PRYOR & HARRIS, ATTORNEYS, NEW YORK.

It may be observed at the outset that the false representations referred to in the title of this paper may have been made by prospectuses, corporate reports or personal statements.

In legal aspect there is little difference between misstatements as effecting sales of securities and misstatements as effecting subscriptions therefor. Just what does amount to a fraudulent misrepresentation, which will give rise to an action for deceit to the purchaser, is difficult to state, each case standing upon its own facts.

In a leading English case Lord Herschell in a very learned opinion thus states the rules which should govern cases of this character:

"First, in order to sustain an action of deceit there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false. . . .

"The test which I propose employing is to inquire whether the defendants knowingly made a false statement in this respect (material facts in the prospectus), or whether, on the contrary, they honestly be-

lieved what they stated to be a true and fair representation of the facts."

When fraudulent representations are made it does not matter if they are not directed to the person who may have been injured by relying on them. If a prospectus, issued for the purpose of obtaining subscriptions or the sales of securities, comes into the hands of a stranger, and, relying upon it, he invests in the securities advertised, and is injured thereby, he has an action at law for damages against the wrongdoer.

On the question of fraudulent intent the Court of Appeals, New York, has held that where the failure to disclose a claim against a company in a statement purporting to contain its entire assets and liabilities was attributable to an honest belief upon reasonable grounds, the fraudulent intent was lacking and the charge of deceit failed.

It was formerly laid down that an action for deceit would not lie against the corporation itself, because the gist of the action is fraudulent intent, and a fraudulent intent is not imputable to an artificial body. The present doctrine, however, is otherwise, and in a recent case in this state against a trust company it was held that a corporation as well as an individual may be liable for false representations in a prospectus issued by it to sell stock of another company.

We now reach the interesting inquiry whether a director is liable for the fraudulent representations of his codirectors. The foundation of this action being fraudulent intent, it follows that an innocent director is not liable for the fraudulent representations of his codirectors. But a director who stands by and allows a codirector to make the false representations is equally chargeable.

The Court of Appeals in this state has declared that the mere fact of being a director or stockholder is not *per se* sufficient to hold a party liable for the frauds or misrepresentations of the active managers of the corporation. Some knowledge and participation in the act claimed to be fraudulent must be brought home to the person sought to be charged.

In its relation to commercial enterprises there are three principal dangers to be avoided by a trust company:

- (a) Connection with the prospectus.
- (b) Responsibility to subscribers for satisfactory underwriting.
- (c) Responsibility for statements concerning the value of the securities.

The necessity of refraining from any connection with or responsibility for the prospectus is so obvious as to need no further discussion. The decisions of the courts are to the effect that responsibility for the state-

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ments therein contained does not require an actual signing of the prospectus, but such facts and circumstances as would lead a reasonable man to believe that the responsibility for the statements contained therein was assumed by the trust company are sufficient to hold it to a legal liability thereon.

In the case of a corporation organized a few years since none of these dangers were sufficiently guarded against. The trustee of the mortgage securing an issue of bonds, having agreed to loan moneys upon notes secured by underwriting of the bonds, allowed its name to be placed upon the prospectus and assumed the obligation of declaring the underwriting to be effective when subscribed in a certain amount by underwriters satisfactory to the trust company.

In this particular case the corporation had parted with all its securities to the promoters on the promoters' agreement to cause certain properties to be transferred to it, and to erect factories and to furnish a certain amount of working capital in cash and returned securities of the company. The corporation, having divested itself of all its securities, was without recourse, except to the financial responsibility of the promoters, which, in this case, was insufficient to enable the corporation to continue in its proposed plan of operation. A large percentage of the underwriters failed to respond to the calls, and those who completed their payments under the contract claimed damages against the trust company for false representations of fact, first, in the prospectus, and, second, in its acceptance of the underwriters, and, third, for concealment of the failure of the underwriters to respond to the several calls for payment, further claiming that the connection of the trust company with the promoters of the enterprise was so close as to make it the agent of the promoters and responsible for the failure of the financial plan.

In an underwriting agreement the sole attitude of a trust company should be that of a lender of money, and it is desirable in all cases that the trust company avoid the responsibility of declaring the underwriting effective as between the underwriters themselves, based upon the amounts subscribed and the responsibility of the underwriters. The only safe method for the lender of money is to regard its own protection and contract to loan the money when the subscriptions, in amount and responsibility, are satisfactory to it as the security for its loan only. Any further extension of obligation on the part of the trust company raises the question of fact as to the due diligence and effort on the part of the lender in respect of the examination into the authenticity of the signatures and the responsibility of the

several subscribers. While due diligence may have been used by the trust company in those particulars, nevertheless the company becomes open to an attack upon the question of fact, with the result that no certain opinion can be expressed as to the ultimate liability of the trust company, owing to the uncertainty of forecasting the verdict of juries on disputed questions of facts, and the impossibility of finding precedents on all fours with the case in hand.

Where disputes arise in a court of law upon questions of fact each case is necessarily decided upon the conditions arising in that particular case, and it is generally impossible to find decisions exactly covering the case in hand. The construction and interpretations by courts of the last resort of the contracts and instruments connected with the combination and congregations of industrial enterprises are at the present time comparatively few and are frequently widely differing in their processes of reasoning and their results announced, public sentiment and public policy of the various political subdivisions affecting to a considerable extent, the rules promulgated by the courts so far as they have gone. An examination of judicial decisions, however, covering a period of the last twenty years, exhibits a tendency on the part of the bench to hold to a stricter responsibility those connected with the formation of commercial enterprises, and, in recent cases, to pierce through the fiction of dummies and figure-heads, and to place the responsibility upon those actually interested in enterprises, for the results of the acts done under their real supervision and control.

No more definite or safer rule, perhaps, can be stated than this: The trust company should remain a trust company, and should exercise the greatest caution in assuming relations involving responsibility for the value of securities.

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NECESSITY.

BY A. J. STALLINGS, C. P. A.

Why not? In the formation of a partnership or stock company where contracts and other legal documents are to be executed, the attorney is always called in consultation to ascertain if these contracts or articles of incorporation are correctly drawn. It is the desire of the writer to demonstrate to the business man that the services of a public accountant in the formation of these partnerships and corporations are just as indispensable as are those of his attorney. The correctness of the opening entries for a set of books to record all future transactions of the new company is of much greater importance and worthy of greater consideration than is customarily supposed. It would be astonishing information to point out the small percentage of books which correctly record the proper opening entries where the services of the public accountant have not been employed.

Unfortunately it is the general custom to rely upon the knowledge of the bookkeeper, who has perhaps entered into the employ of some firm as office boy and by constant and conscientious efforts advanced to the bookkeeper's desk. His well-earned knowledge is all right so far as it goes, but it is limited to the ordinary routine recording of daily transactions only, such as cash receipts and disbursements, entering invoices of goods received and goods shipped, posting to ledger accounts and taking trial balances. Thus, it can readily be seen that the scope of his experience does not in most cases extend far enough to enable him to spread upon the books of a new company, in proper form, the assets and liabilities obtained from the minute books and various other sources.

The public accountant, with a long and varied experience, is well equipped to do this work. His training is not only in the knowledge of figures and accuracy, but includes a thorough knowledge of all business transactions, where knowledge is power and experience a necessity.

INDIANA ASSOCIATION OF PUBLIC ACCOUNTANTS.

At the last meeting of the Indiana Association of Public Accountants, whose head office is in the Fitzgerald building, Indianapolis, it was decided to incorporate the association. Proper legal documents have been filed and the advantages attaching to a state organization secured. The president of the association is J. H. C. Denman; vice-president, E. B. Osborn; secretary and treasurer, C. E. Freeman.


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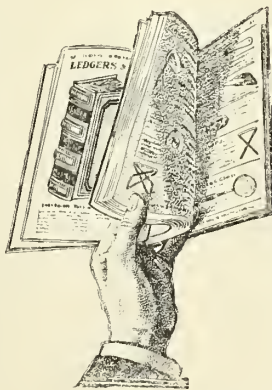
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DATE REPORTED.	ACCUSED.	AMOUNT.	POSITION.	ADDRESS.
Nov. 20	Miss Fanny M. Colby..	\$ 5,000..	Cashier.....	San Francisco
" 25	James Wallace.....	30,000..	Clerk.....	Marquette, Mich.
" 25	Ralph D. Boyington...	338..	Station Agent.....	Ravenswood, Chicago
" 24	John D. Green.....	500..	Manufacturer's Agent.....	Chicago
" 19	Sheldon T. Bent.....	3,000..	Manager.....	Montreal, Canada
" 18	W. W. Leighton.....	41,000..	Bank President.....	Lima, O.
" 19	James Stanford.....	1,200..	Clerk.....	Muncie, Ind.
" 19	Dr. Calvin Hathaway..	14,000..	Bank President.....	Montpelier, O.
" 23	Arnold Beauthien.....	60,000..	Bank Cashier.....	Davenport, Ia.
" 22	J. W. Whitman.....	1,000..	Clerk of Court.....	Van Wert, O.
" 20	N. S. McClurken.....	1,000..	Collector.....	Los Angeles, Cal.
" 23	William Golden.....	800..	School Treasurer.....	Independence, Ia.
" 17	M. L. Clifford.....	1,000..	Manufacturer's Agent.....	Butte, Mont.
" 24	Chas. H. Long.....	95..	Station Agent.....	Modesto, Cal.
" 30	Frank R. Chandler.....	1,500..	Real Estate.....	Chicago
" 28	O. C. Higbee.....	2,800..	Manager.....	Papillion, Neb.
" 24	Thos. Heaslip.....	2,500..	Assistant Postmaster....	Minto, Man., Can.
" 26	John W. Kelley.....	600..	Station Agent.....	Jessup, Md.
" 26	R. A. Woods.....	25,000..	Secy. Savings Bank.....	Lima, O.
" 27	H. H. Disbrow.....	550..	Commercial Traveler.....	Keosauqua, Ia.
" 30	H. O. Barber.....	37,120..	Bank Clerk.....	Cambridge, O.
" 22	Oscar F. Funke.....	100..	Solicitor.....	San Francisco, Cal.
" 24	E. R. Henderson.....	40,000..	Railroad Auditor.....	Macon, Ga.
" 24	Fred Bower.....	400..	Clerk.....	Cincinnati, O.
" 21	James P. Storm.....	15,000..	County Treasurer.....	Prescott, Ariz.
" 30	Chas. O. Erbaugh.....	10,300..	Attorney.....	Denver, Colo.
" 29	Charles Neff.....	1,200..	Clerk School Board.....	Columbus, O.
" 29	H. D. Ferguson.....	1,285..	Hotel Clerk.....	St. Louis
" 30	Alfred Bischman.....	1,700..	Bookkeeper.....	Milwaukee
" 29	John M. White.....	174..	Clerk.....	Marion, Ind.
" 28	Blumenthal	£250,000..	Manager.....	London, Eng.
" 30	Aug. Schoub.....	\$ 35..	Collector.....	Indianapolis
" 29	A. O. Baker.....	1,200..	Supt. Waterworks.....	Wellington, Kan.
" 28	Chas. B. Thompson....	20,000..	Treasurer Coal Co.....	Petersburg, Ind.
" 28	F. M. Tibbals.....	1,700..	Postmaster.....	Bridgeport, Conn.
" 29	Gus Ray.....	500..	Collector.....	St. Louis, Mo.
" 27	John Case.....	8,908.91	Tax Collector.....	Montgomery, Ala.
Dec. 2	C. H. Colins.....	25,300..	Bank Cashier.....	Des Moines, Ia.
" 2	W. H. Colton.....	25,000..	Bank Cashier.....	Wapello, Ia.
Nov. 29	Sol. Seligman.....	70..	Agent (Commercial).....	Flint, Mich.
" 29	Jos. Wardell.....	500..	Collector (Com'l)....	Atlantic City, N. J.
Dec. 1	Gus Klein.....	106..	Salesman.....	Covington, Ky.
" 5	Wm. J. Mendum.....	21,000..	Executor.....	Portsmouth, N. H.
Nov. 25	H. D. Wilder.....	1,400..	Agent.....	Knoxville, Tenn.
" 24	W. R. Eaves.....	8,000..	Bank Teller.....	Arlington, Tex.
" 29	Gus Ray.....	500..	Driver.....	St. Louis, Mo.
Dec. 3	A. Martineau.....	70,000..	Government Clerk.....	Ottawa, Ont.
" 6	James F. Lingafelter...	75,000..	Bank Cashier.....	Newark, O.
" 3	G. C. Lee.....	100..	Salesman.....	Memphis, Tenn.
" 6	Charles Frost.....	15,000..	Confidential Clerk.....	East St. Louis, Ill.
" 6	A. S. Allen.....	32,000..	Private Secretary.....	Omaha, Neb.
" 4	L. Balliett.....	260,000..	Mine Manager.....	California
" 4	Lewis Hoffman.....	2,500..	Partner.....	Grand Rapids, Mich.
" 2	Oscar Adler.....	25,000..	Private Banker.....	New York City
" 6	J. H. Wood.....	10,000..	Bank President.....	Matthews, Ind.
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THE DUTIES OF PROFESSIONAL ACCOUNTANTS IN CONNECTION WITH INVESTED CAPITAL BOTH PRIOR TO AND SUBSEQUENT TO THE INVESTMENT

BY FRANCIS W. PIXLEY, F. C. A., BARRISTER-AT-LAW.

As the representative of the leading Institute of Professional Accountants in the "Old World," I should have liked, in a paper addressed to this first great congress of members of the profession assembled in the "New World," to have commenced with reminiscences culled from our past history, to have dealt reverently with the memory of some of my predecessors in the presidential chair, and in other ways to have introduced some romance into what must be necessarily, without it, a dry paper. I well know the veneration possessed by your countrymen for old traditions and old memories, and it is a regret that I cannot indulge in recollections of the past.

Much, however, as Americans value antiquities—as is evidenced by your acquisition of works of art of every description from the countries of the Old World—and much as you cherish old customs brought by your ancestors from the mother country, yet you in your inmost hearts are, I am convinced, prouder of the advance our country has made in the past fifty years, and the way in which it has crept up to and gradually surpassed the countries of the Old World in many departments of commerce and finance, than of any exploits in the past of those from whom you may claim descent. For the same reason, I am convinced that the representatives I have the honor of

addressing of what is in America, as with us, a comparatively new profession are better pleased to be pioneers of this profession than to be merely the heirs of recognized forms and customs which they are expected to follow. Tory though I am, I fully sympathize with this sentiment.

Proud as are the members of some professions of their antiquity, of customs carefully preserved, although in many instances out of date, yet to assist in the establishment of a new profession, to feel you are one of those helping to form the professional character of those to follow in your footsteps—to be, in fact, one of the fathers of a profession—appeals to me, as I am sure it does to you, more than to merely step into the shoes of those who have gone before, and to follow a beaten path out of which it is unwise to stray.

We—and I am speaking of our professional brethren on the other side of the Atlantic as well as for the members of those societies forming the federation under whose auspices is assembled this great congress—are making this beaten path for others to follow. I am sure you will agree with me that a heavy responsibility consequently rests upon us, as the doctrines we lay down for ourselves to follow must necessarily not only have a great and abiding influence on our successors, but also

show the financial and commercial community of the present day whether they can confidently entrust us with the great and important duties we profess to transact so as to secure for ourselves and our successors that general feeling of confidence without which no profession can flourish even for a time, much less endure, as we hope ours will, in the ages to come.

Although the profession of accountancy is comparatively speaking a new one, yet the most important branch of our work has a distinct claim to antiquity. It is certain that for over six centuries the office of auditor has existed, as in 1299 we find mention of an auditor of the accounts of the Corporation of the City of London. In the "Vision of Piers Ploughman," written by Langland, and published in 1377, and in Paston's "Letters," written in 1469, references to auditors are found; while in Shakespeare's play, "Timon of Athens," the following lines appear:

"If you suspect my husbandry or falsehood,
Call me before the exactest auditors
And set me on the proof."

On a tombstone in the old Church of St. Mary, Chesham, Berkshire, is the following quaint inscription recording a death which occurred in 1626: "Here lyeth Richard Bowle, who faithfully served divers great Lordes as Auditor on earth, but above all he prepared himself to give up his account to the Lord of Heaven, and rests from his torments and labors."

Auditors, however, of those times were not selected from any particular body, and I fancy a very slight knowledge of accounts, or perhaps only an assumed knowledge, was all that was required to obtain the office. This is scarcely to be wondered at when we reflect that even in these practical times the duties of auditors are frequently entrusted to persons who have given no proof whatever of possessing the necessary qualifications for their duties.

Although lawyers, actuaries and valuers

have for long been deemed necessary adjuncts to finance and commerce, yet, strange to say, even in your country professional accountancy is of modern growth. I think I am justified in claiming that it is an importation from the other side of the water; and it was the practical common-sense which distinguishes our fellow countrymen north of the Tweed, which first recognized the necessity for the professional accountant.

Our Scottish brethren are about to celebrate the completion of the first half century of the recognition of professional accountancy in the United Kingdom of Great Britain and Ireland, in commemoration of the fact that on the 23d of October, 1854, the Society of Accountants in Edinburgh was incorporated by royal charter. It is, of course, apparent that accountancy as a profession existed earlier than this, otherwise its members would not have had sufficient influence to obtain a royal charter forming themselves into a corporate body endowed with certain privileges. Previous, however, to the granting of the royal charter there was not much recognition or notice taken of the practicing accountants, while from the date I mentioned chartered accountants have in Edinburgh held a very high position, not only in the estimation of the commercial and financial world, but also in the social life of the Scottish capital.

The following year a similar society in Glasgow obtained a royal charter, and twelve years later another society in Aberdeen was similarly successful. At the present moment all the recognized members of the profession, whether practicing in Scotland itself or in other parts of the world as chartered accountants of Scotland, belong to one of these three chartered associations.

Although my paper is not intended in any way to be historical, yet I feel that, having regard to the present occasion, some reference to the origin and growth of the profession in the United Kingdom will not be considered out of place. I will, however,

confine myself to a very short reference to this subject, and will content myself by adding that in 1880 various associations of professional accountants practicing in London and some of the principal provincial towns in England were incorporated into one body under the style of "The Institute of Chartered Accountants in England and Wales." This institute has met with ever-increasing success, not only in the esteem of the legal, financial and commercial world, but also in the gradual and steady addition to its numbers. It now contains about 3,200 members, and I am proud that, on the kind invitation of the Federation of Societies of Public Accountants in the United States of America to send a representative to this congress, they have done me the honor to select me to be their representative.

In order to complete my short statistical statement, I have to add that in 1888 the leading members of the profesison in Ireland were incorporated by royal charter under the style of "The Institute of Chartered Accountants in Ireland," and at the present moment the chartered accountants of the United Kingdom are upward of 4,000 in number, divided among the various institutes as follows:

Members.

The Institute of Chartered Accountants in England and Wales.....	3,200
The Society of Accountants in Edinburgh	390
The Institute of Accountants and Actuaries in Glasgow.....	410
The Society of Accountants in Aberdeen	50
The Institute of Chartered Accountants in Ireland.....	70

Special provisions were made in these charters for the purpose of safeguarding the interests of those who, while not being in actual practice at the date of the charter, it might be inferred, through their being in the chambers of a practicing accountant, that they intended at some future date to

follow the profession. Although it is now nearly a quarter of a century since my institute obtained its charter, yet it is possible even now for those who at the date of the charter were practicing as professional accountants to be admitted as members, and also those who were clerks. In other words, provision was made for taking into our ranks anyone who at the date of the charter was only a boy in a professional accountant's office.

Notwithstanding this, there later on appeared persons who wished to practice as professional accountants without qualifying themselves in the manner prescribed by the charter; and as the charter, unfortunately, granted no monopoly—such as is enjoyed by barristers, solicitors and medical men—other societies of accountants have been formed under various distinguishing names.

This is much to be regretted, but they have practically done the chartered accountants little if any injury. In his address to the seventh provincial meeting of the Institute of Chartered Accountants in England and Wales, held at Birmingham in 1901, Mr. Walter N. Fisher, the president, stated that, as a result of an analysis of the London Stock Exchange Official Intelligence of that year, he had ascertained that of 4,166 companies 3,133 were audited solely and 185 partly by members of the English Institute, and 321 by members of the Scottish and Irish societies, and that out of the remaining 527 companies 444 were apparently audited by private individuals, or, at any rate, by persons not belonging to any society.

Now, although a large portion of the practice of chartered accountants—in the United Kingdom, at any rate—consists in the holding of certain public offices, such as liquidators, trustees, receivers, administrators, etc., yet we practically hold all these offices by reason of our special aptitude for investigating accounts, and the greater portion of our work consists in our

being professionally employed on behalf of those who are either about to invest their capital, or, having invested it, wish to be informed from time to time as to the financial result of its investment.

Professional accountants acting for investors of capital are either instructed by persons who intend to invest their own capital in some established business or enterprise, or they may receive their instructions from those who do not intend to make any investment themselves, but only wish to induce others to do so. In the former case they act for a client who, having had a proposition placed in front of him requiring capital either to develop a new enterprise, or to increase an existing business by means of additional capital, or to replace the capital of a retiring proprietor, so far entertains the proposal that he is prepared to embark in it should the investigation of the accounts bear out the statements made to him. In the latter case they receive instructions from persons about to float an enterprise whose object is to induce others to invest their capital on the strength of the profits earned in the past, as certified by the professional accountant. In both these cases a responsibility lies on the accountant, and while in many respects his duties are similar, yet in the second instance they are vastly more responsible.

When acting for a private client the responsibilities of a professional accountant are limited to a great extent by the instructions given him. For example, supposing his client wishes to purchase a business or acquire an interest in one as a working partner, he may, if a capable business man, limit the extent of his accountant's investigation. He may have been long acquainted with the proprietor of the business, and be so thoroughly satisfied as to his honesty as to only require a partial investigation of the accounts; as a result, he may possibly instruct his accountant to accept certain details as correct, and, by taking totals, pre-

pare therefrom a profit and loss account for the number of years he may select, and report to him thereon.

To those unacquainted with the method of preparing statements of account this may seem a roundabout way of accepting the profit and loss account and balance sheets as prepared for the vendor by his own bookkeeper, but professional accountants are well aware that from the same "Trial Balance" statements of profit and loss may be prepared showing very different results, but without any deception being intended. The bookkeeper of the vendor, who has been in the habit of placing before his employer annual statements showing the result of the business operations, has perhaps proceeded on the same lines year after year, making the same allowances for losses likely to arise on the realization of book debts, calculating for depreciation on plant and machinery the same annual percentage, and in the same manner on some fixed principle arriving at the value of the stock-in-trade. He may possibly, acting on instructions from his employer given to him years ago, have omitted to charge interest on the capital employed in the business, and in other ways have prepared profit and loss accounts and balance sheets which, although understood by his employer, might be misleading were they to be accepted by a purchaser or an incoming partner as a basis for fixing the price to be paid for the whole or a share of the business.

When a professional accountant receives limited instructions from a client about to invest his capital he will naturally in his report showing the result of his investigation carefully guard himself by referring to these instructions, and point out what he has omitted to look into, which, had he been left unfettered, he would have deemed it necessary to have investigated. Clients who lose their money have an unfortunate habit of trying to fix the blame on their professional advisors, be they lawyers, stockbro-

kers or accountants; and as a matter of ordinary precaution reports on investigations of every description, whether the accountant is left free to pursue his own course or is restricted in any way, should be so carefully worded as to give the client no opportunity of being able to prove that the accountant neglected any portion of an investigation necessary to fulfill his duties efficiently.

The responsibility connected with an investigation is, of course, heavier where the client is a man of inexperience, and who, either having capital of his own or capital which has been found him by his parents or guardians, wishes to venture the same in a business of which he has little or no knowledge, and has subsequently to rely on those he may intrust with the management. The most serious responsibilities, however, in connection with investigations prior to the investment of capital are those where the professional accountant receives instructions from the promoter of an enterprise to be launched as a joint stock concern, the capital of which is to be found by those who may be induced to subscribe the same on the faith of a prospectus supported by his certificate.

Previous to commencing the actual work, there are two most important elements that have to be considered, namely, the promoter of the proposed company and the proprietor of the business whose accounts have to be investigated. Where the promoter has been long known to the accountant, and he has conducted investigations for him on previous occasions which have led to satisfactory results, he need not consider this; but if he is making an investigation for a promoter for the first time, then it is most important that he should make inquiries as to his antecedents. However true it may be that an accountant has to confine himself almost entirely to facts, yet it is most dangerous for him to act on behalf of a really unscrupulous promoter. As regards the

proprietor of a business, it is unlikely that he will have met him before, and in this case it is also desirable that he should make some independent inquiries as to his character, as there are risks also in certifying to the profits of a business of an unscrupulous person who may wish to entirely dispose of it. Bearing this in mind, the accountant should make himself acquainted with the reason for the proposed conversion of the business into a joint stock enterprise, as although there may be very many legitimate reasons—such as an elderly man wishing to relinquish a portion of his labors; the division of a business into a larger number of holdings than can be dealt with in an ordinary deed of partnership; a death, or other family reasons; or for the very legitimate reason of wishing to retire from business altogether—still, experience has shown that many proprietors of declining businesses have taken advantage of the facilities which exist for transferring them to joint stock companies. In many of these cases they have, I regret to state, been assisted by disreputable professional men; but frequently they kept their dishonest intentions to themselves, with the result that entirely innocent lawyers and accountants have been implicated without being guilty of any worse crime than carelessness in not having investigated the antecedents of their clients.

In an investigation conducted under these circumstances, although certain instructions must of necessity be given to the accountant by his client, the promoter, the former must to a certain extent, and in some cases to a very great extent, retain in his own hands the decision of a number of points which in an investigation for private clients might be limited by his instructions. I do not, of course, lay down the doctrine that a professional accountant is a guardian of public morals, or has to act with paternal solicitude on behalf of those who may, by means of his certificate, become an investor in an enterprise such as I am indicating. All I wish

to claim—and I trust you will support me in this—is that, in giving a certificate under the circumstances I am considering, a professional accountant must not consider that he has done his duty when he has certified as correct a statement or statements of account, which on the ground of arithmetical inaccuracy cannot be assailed. This is a view of a professional accountant's duties which the members of the chartered institutes of the United Kingdom would not support for one moment, and I feel sure that on this side of the Atlantic you would not desire to set up a lower standard of professional duty.

The Institute of Chartered Accountants in England and Wales has not, any more than has the governing body of any of the other learned professions, attempted to prescribe rules for the ordinary conduct of its members in connection with professional work, but certain matters connected with the subject of this paper have been brought to their notice from time to time, and, without in any way attempting to speak for the institute on such an important matter, I will content myself by stating that the leading members of the profession in England have come to the conclusion that it is extremely improper to give certificates for the purposes of influencing the investment of capital under certain conditions, of which I may give the following as examples:

Should it be intended to invite capital for a company formed to take over an existing business, and it is proposed to insert in the prospectus a certificate of a professional accountant, one of average profits may be given where the profits have increased annually during the series of years embraced by the certificate, but it is not considered proper to give a certificate of average profits where the profits have declined. In such cases it is considered essential that the profits for each year must be set out in the certificate, and appear clearly in the prospectus

of the company, it being deemed that every intending investor has the right to know before he invests his capital that it is going into what appears, according to the books of the concern, a declining business. In other words, those who are a party to concealing the above facts by giving a certificate of average profits without any qualification are guilty of professional misconduct. Should the annual profits be clearly set out, and the directors give an explanation of the reason of the decline in a paragraph in the prospectus, and the intending investor be so satisfied with this as to invest his money, this does not then concern an accountant who has done his duty. It is, of course, to be understood the accountant has no reason to suppose that the explanation is a false one, as it is not, of course, proper for him to allow his certificate to appear in a prospectus which contains any fact whatever which to his knowledge is untrue or misleading.

In the case of an entirely new enterprise which has only been tested in a small way, and capital is to be invited to practically exploit the process, there will be no objection to the accountant giving a certificate as to the result of the working of the experimental process. It would, however, be extremely improper for him to issue a certificate giving the probable result of the working of this process on a considerable scale by taking into consideration estimates for the probable working expenses of the company, and thus showing that the profits under those circumstances would yield a certain dividend on the capital asked for. The accountant must confine himself to absolute facts, leaving it to the directors to put forward any estimates; and, provided that he has every reason to believe that the directors are making their estimates in a bona fide manner, he cannot object to their making use of his certificate of facts.

To be continued.

SYSTEMS AND SYSTEM MAKING

BY WILLIAM H. ROBERTS, C. P. A.

Up to forty or fifty years ago the legal profession, at least in this country, comprised only plain lawyers, ready to tackle any kind of litigation from "clothes-line" cases to international complications, and corporation, criminal, patent, and a dozen other branches of practice were then almost unheard of.

Physicians in those days were simply doctors, treating everything and everybody as best they could, little dreaming, most of them, of the day when the profession should be divided into more branches than the layman can number, much less remember the names of.

Probably no one will deny that these changes are "signs of the times" and proof positive of scientific and material advancement, or that the same tendency to specialize which long ago evolved the accountant from the bookkeeper and the professional from the class who opened and closed books nights and Sundays is still apparent. It is not only as natural and certain that specialties should develop in our profession as in any other, but the fact that such development is taking place is a proof of the increased interest and confidence of the public generally in our work.

The newest and one of the most important features of accounting work, and one which is naturally a specialty, is the designing of systems of accounting, cost keeping and office organization generally, which includes the details of handling men, materials, machinery, correspondence, sales and finances and all the records required, whether made in the office or not.

Right here is probably a good place to insert a little "want ad," both in hope of a prompt answer and also to encourage "The Auditor" along the steep and rocky path which leads to the pinnacle of journalistic

success. Wanted—just the right name for this branch of our profession and the corresponding designation for the man who devotes his best thought and energy to it.

The word "System" is just now a little under a cloud by reason of having been too often seen in questionable 'company. It has been used and abused by all kinds of office supply dealers, furniture makers and the mail order crowd generally, until it means most anything, from a set of copyrighted "follow-up" forms, to a stack of vertical files, and it fails to convey to the plain business man any idea of the kind of service which this article will attempt to describe.

The derivatives of this word, too, are hopeless. "Systematizer" is simply "impossible," and the man who tries to sugar-coat the dose by calling himself a "Systemizer" reminds one of the ex-bookkeeper who announced himself to a startled public as an "Adept Accountant."

The terms "Business Engineer," "Business Counsel" and "Office Organizer" are a little better, but are quite too vague; "Production Engineer" does not convey the accounting idea at all and "Cost Accountant" covers at best only one part of it. In short, a name which is euphonious and sufficiently descriptive, both inclusively and exclusively, is still lacking and a suitable reward should be offered for its prompt discovery.

However, as it is not quite so important to have a good name as to deserve it, we may profitably consider how to do the latter while waiting for the former.

A specialist in law or medicine must, of course, be well grounded in the general knowledge of his profession and this is even more necessary in the accountant who attempts to design systems.

A patent attorney, for instance, may ignore or forget much that his brother lawyers need to know every day, but the designer's work constantly touches upon every other phase of accounting; he must always have in mind the necessity for an economical but thorough audit, the prevention of error and fraud and the presentation of a prompt, clear and comprehensive balance sheet whenever required. There ought not to be much room for argument as to the value, or, rather, the indispensability of broad experience in public accounting as a prime requisite for success in system designing, but from the amount of work which has been done and is being done by the "mercantile experts" this need seems to lack recognition by the general run of business men, who pay their money and don't get much of any choice.

One reason for the ready acceptance of most any kind of work has been the general ignorance and indifference of the average business man regarding accounting as a science, another is the rapid growth of business which has fairly carried the managers off their feet and caused them to grab at anything which promised relief, and, in many cases, it did not require any great talent to make matters a whole lot better and thereby earn the gratitude of all concerned, if not the fees charged.

There is another important element of success which neither knowledge nor experience can supply, although they certainly do stimulate and develop it, namely, a talent or gift of inventiveness—resourcefulness—initiative; the ability to meet new difficulties with equally new expedients to the end sought.

There is no limit to the amount of detail and complication incident to modern business and the difficulties are growing all the time. Not only are the system requirements of two concerns in the same line very different, but a system which fits like a glove to-day may have to be readjusted a

year hence to provide for expansion or new conditions.

Here are a few negative specifications which are of very positive importance to the system designer:

Don't forget that you're on earth to pry other people out of ruts, so avoid getting into any yourself.

Don't have pet forms or methods; remember that your clients pay (or should pay) for originality where it is needed, and there are few places where it is not.

Don't try to alter a business to fit a system; leave that sort of thing for the "correspondence school" graduate.

Don't tell a prospective client just what you can do to improve things; he may think you're a "four flusher," and then again, when you come to study the situation, you may find you were mistaken.

Don't be positive or arbitrary on any point until you have mastered every detail of the business, for one thing depends on another and you will often find some little "kink," perhaps by accident, which will upset all your plans and force a new study of the whole problem.

Don't take for granted all that is told you about the impossibility of changing this or doing that—prove it. Inertia is the chief mental characteristic of many bookkeepers and quite a few managers.

Don't provide for clerical work to be done outside of the office if it is possible to avoid it. A good superintendent or foreman is often spoiled for the sake of some very poor records or reports which might, by proper plans, have been just as well made in the office.

Don't forget that while "the man who makes two blades of grass grow where one grew before is a benefactor to the race," the designer whose plan compels the making of two entries where one might serve has missed his calling and should try agriculture.

Don't be in too great a hurry to present

a plan—not that you should waste time or “soldier”—far from it. But the weariness which follows the attempt to rapidly digest a mass of detail such as is presented in almost any business, manufacturing particularly, is a temptation to quit too soon. Again, an engagement in a line of business with which you are already familiar may be unsuccessful because over-confidence has caused you to skip a few important points not found in previous experience.

Don't accept an engagement unless it includes your services for installation as well as designing. When it comes to actual practice the “knocker” gets in his work (there is usually more than one) and, as a consequence, many a good piece of work has failed when left to start itself. On the other hand, not a few very indifferent jobs have produced great satisfaction and a reputation for the designer as a result of his careful instruction during the trying period of “breaking in.”

Above all things, don't try to force the sale of any special devices—furniture or other commodity. Recommend what is best for the purpose (more than one make, if possible), not more expensive than the case will warrant, and never under any circumstances ask or accept a commission on supplies you may be required to order.

It should not be, and probably is not, necessary to caution any certified public accountant regarding an act so unprofessional, but the matter is really too important to be omitted entirely. Good work should and nearly always does command ample compensation and your client is entitled to expect and to get all the advantage in purchase of supplies, printing or furniture which you are able to secure.

Don't take with you to a new engagement any ideas gained in previous experience along similar lines—forget them all. Study what is before you as an entirely new problem; divide it into sections if you

can; study them separately and then as a whole, but nothing short of *learning the business* will answer, if good results are to follow.

How shall a business be studied? That is a question with a different answer for each case, and when you have found the answer you have got a good start toward success.

By the way, don't take an engagement unless you are reasonably assured that your *backing* is ample, that what you recommend will be done and results be expected only after a fair trial.

The manager who, having decided that he can be helped by a specialist and having employed you, will say to an objecting or skeptical head of department, as one manager did in the writer's experience, “We have employed this man to improve our methods and what he recommends will be put in effect and given a fair trial, and whoever gets in the way will surely be run over,” has fought half your battle if he only *sticks to it*.

Don't expect that you can learn the business or even the strictly accounting features of it from the books. In fact, they should usually receive consideration last.

Learn first the actual business details—the movement of merchandise manufacturing operations—handling of orders—anything and everything in fact that goes to produce or affect the final result we all aim at—the bank account.

You will discover some things which ought to be found in the bookkeeping and are not, some which are there but need not be, and many other matters which affect your design which in their nature could not be discovered even by a careful audit of the general books.

Don't limit your system to bookkeeping methods unless compelled to do so by your client. Handling of correspondence, advertising, salesmen, pay rolls, manufacturing cost, shipping, and many other features

are as important and as much within your province and duty as the accounting in its narrow sense and they often present greater opportunity for betterment.

Don't lose sight of the fact that a cost system which is not a part of and whose results are not proved by the general books is a delusion and a snare.

Very many manufacturers and just a few accountants fail to distinguish between cost figuring and cost accounting.

The necessary study completed and your plans accepted, don't fail to again give careful thought to each form designed, both as to its fitness for its purpose and its relation to every other form to be used. Harmony is worth a struggle anywhere and a little neglect may result in some annoying and discreditable little misfit whose effect in spoiling an otherwise smooth working scheme is out of all proportion to its importance in any other way.

Don't fail to give close attention to little details of execution by the printer—sizes, quality and colors of paper, type, rulings and bindings—in fact, no detail is too small to deserve your utmost care; even with it some things will probably be overlooked.

The quality of paper and binding should be carefully considered with reference to their use, economy practiced where possible and durability secured where needed.

The writer had occasion recently to recommend for a certain use a loose leaf form about 8½ by 17 inches, bound on the end, and was told that it was wholly impracticable, had been tried for the particular purpose and abandoned as a failure. On a request to see the book a binder was produced of the familiar hinge-back, curved-prong, non-compression type, with the leaves torn at the punchings, loose, irregular and generally disreputable.

The substitution of a suitable compression binder made a success out of that failure. Almost as great a mistake might be made by putting in a compression or post

binder where sheets are constantly shifted and where the hinge back would be vastly more convenient.

Don't make the mistake of giving a looking-glass and a hammer to a baby—in other words, don't make your system beyond the capacity of the management or the help. Better to do little and succeed, than more and hurt your reputation and your client's feelings and bank account by giving him something he can't use.

This brings up the other side of our subject—causes of failure in system work, which are not by any means confined to lack of ability on the part of the designer, and are numerous and important enough to deserve separate treatment in a future article.

A WISE GOVERNOR

In his first message to the legislature, which was also his inaugural address, Gov. Chas. S. Deneen of Illinois called the attention of the lawmakers to the necessity for uniform accounting methods in connection with the affairs of the various state institutions. This expression on the part of the governor encourages the accounting profession to believe that he will be found not averse to going still further and giving his sanction to the regular auditing of the affairs of all institutions, boards and commissions charged with the duty of distributing state funds. There should be a determined effort made by the accounting fraternity to bring to the attention of the proper state officials the crying need for independent supervision of accounts of which have been heretofore more or less irresponsible boards, who seemed more intent upon spending the whole appropriation than upon disbursing such part thereof as was necessary. The introduction of business methods into public offices cannot be avoided much longer. So let the reform come quickly.

LEGAL INVESTIGATIONS

BY EDWARD E. GORE, C. P. A.

It is not to be expected that within the limits of an article designed to occupy a certain amount of space, and no more, an exhaustive treatise on a subject having many sides can be given. An attempt, therefore, will be made only to touch upon those features of legal investigations seeming to be of the most pressing importance to the accounting profession. Many accountants look upon this class of work with feelings akin to horror, for it brings them away from familiar ground, to do battle on strange premises. The observations here recorded are the fruit of a somewhat extended experience in this department of accountancy work, and they are given in the hope that they may prove of benefit to those members of the accounting fraternity who have so far been called upon to care for few engagements of this character.

For the accountant to be successful in this class of work it is necessary that with his ability to discover facts should be combined the faculty of explaining his discoveries. There are many able accountants who, after ascertaining every fact bearing upon a proposition, cannot mount the witness stand and give the court, the jury and the interested parties any intelligent idea of what he has found. One cause of this failure to "make good" is that many accountants grow accustomed to thinking and expressing themselves in language altogether too technical for the understanding of men who do not know a debit from a credit or an asset from a liability. Another cause for failure in this department of accounting is that most accountants are given to doing things with great thoroughness and quite systematically; and when asked to tell what they have found they feel that it is necessary to tell in full detail all that they did, why they did it and the results of every ef-

fort they have put forth. The consequence is that when fairly launched on a long story calculated to give them celebrity for exhaustive research they are brought up with a sharp turn by the examining attorney requesting them to "tell what you found, we don't care how you found it." A few such comments by a bullying or patronizing attorney are generally sufficient to so embarrass the accountant that he begins to wonder if he really ever had any sense, and to resolve within himself that, once done with the case in hand he will forever after devote his energies to plain audits, or the construction of simple systems. While these causes are frequently present, by far the most common reason for the failure of an accountant to get through a litigated matter creditably, is to be found in his ignorance of what facts are really germane to the point at issue. After leaving the witness stand, with his head in a whirl, and his body perspiring freely, he can't understand why the lawyer who engaged him wears such an injured look and seems so anxious to avoid him. Neither can he understand why the opposing counsel seems so happy and restrains his apparent amusement with so much difficulty. The chief trouble lies in his attempting to inject into his testimony a whole yard of facts that do not apply to the *crux* of the matter, quite unmindful of the rules of legal procedure which contemplate the laying bare of essential facts, with only enough collateral matter to give them support. The first mistake the accountant is likely to make is in laying out his work. In all probability he will attempt to conduct a legal investigation along the lines of an ordinary audit, thus collating a vast amount of information that for use in court is absolutely worthless. To avoid this error he should first insist upon understanding fully what is the nature of

the controversy, and exactly what are the points at issue. When the disputed points are known the accountant should drive straight at them and after ascertaining the truth about them should then carry his investigation only far enough to enable him to give good reasons for his findings. These reasons, however, need to be absolutely conclusive, for if on cross examination they are not sound in every respect and wholly unassailable, the opposing counsel will so embarrass the witness as to destroy much of the value of his testimony. It would prove of great advantage to the public accountant to carefully study some good work on the law of evidence, as a preparation for the legal investigations he will in the course of his practice be called upon to make. By this means he will learn what evidence is admissible and what will be excluded, and will avoid the error commonly made of piling up a mass of information which cannot be admitted as proper testimony under the rules of evidence.

A knowledge of the laws of evidence will prove of great value in still another respect. It will make the accountant a good witness. By a "good witness" is meant a witness who can testify to facts within his knowledge without confusion, and can repeat his testimony and explain the same, if called upon, without any uncertainty as to the soundness of any position he has taken. In order to be a "good witness" he must be entirely immune from surprises. Nearly every lawyer in conducting a cross examination counts upon his ability to surprise a witness and thus confuse him. If the witness has familiarized himself with the laws of evidence he will know when a lawyer begins his examination, to what climax the questions propounded are leading, and he will soon know that these questions have a regular sequence, so that when one is asked he can readily surmise what the next will be, and when it comes it will not find him unprepared. The public accountant serving as a

witness need not anticipate any of the disconcerting questions, of a more or less personal character, which are directed to witnesses of only ordinary accomplishments, since his knowledge will be of strictly specific facts to which the examining counsel will be confined in his examination. This is true because before giving his testimony the accountant will be compelled to qualify as an expert, or, in other words, establish the fact that by experience and training he has a superior knowledge of accounts. Having thus established his standing before the court, he will find the questions asked will relate strictly to the matters with which he has dealt professionally. To be sure, the accountant may, in establishing his qualifications, lay himself open to a severe cross examination, but if he does so he will have only himself to blame. In establishing his qualifications it is only necessary that the accountant state the nature of his profession and how long he has been engaged in it. Then if the examining attorney wants further details they should be given in response to his interrogatories, but in no event should testimony on this subject have the appearance of being volunteered. Nothing goes so far toward inciting a nasty cross examination as the appearance of self-satisfaction, which is given by a long-winded recitation of one's own qualifications and experiences, especially if such recitation have the slightest appearance of being voluntary and not directly responsive to questions. To illustrate the effect of an error of this kind on the part of a witness it may be interesting to relate a circumstance which occurred a few years ago in the trial of a case wherein an expert in electrical machinery of youthful appearance was introduced as a witness, and, as is customary, was asked to state his calling, how long he had been engaged in it, and what his experience had been. He replied that he was an expert in all matters touching the production and use of electric current, having been en-

gaged in occupations intimately connected with the use of electricity for almost ten years. Then, without further questioning, he volunteered the information that he had supervised the erection of a well-known plant in Fort Wayne, had filled the chair of electrical engineering at one of the leading eastern universities, had served as consulting and supervising engineer for a very large plant in Pittsburg, had established the school of electrical engineering in a popular western university, and had done so many other things of great importance that it would seem he must be at least a hundred years old. He then proceeded to give testimony strongly in favor of the party producing him as a witness. When the opposing counsel took up his cross examination he said: "Mr. X, you say you supervised the erection of the ——— plant in Fort Wayne?" Mr. X replied, "Yes, sir," with every evidence of great satisfaction with himself and his accomplishments. The attorney then asked him if he had done the other things he claimed in his direct examination to have done, taking each up in the order of their original announcement, and, after dragging through the long repetition, finally asked, "Mr. X, besides doing all the other important things you have testified to, did you ever find time to hunt the wild ass in Persia?" The laugh which followed this question, in which the jury joined, destroyed the value of the expert's testimony, for there wasn't a juror who did not believe that the witness had greatly exaggerated the extent of his experience, and therefore placed slight confidence in the testimony he had given bearing upon the points at issue in that case.

There are few places where it pays to toot one's own horn to the exclusion of all other sounds, and the witness stand is not one of the few. Whenever such a course is possible it is best to go over the findings with the attorney, in the interest of whose client the investigation has been made, and

explain to him fully what such findings are. He will then learn how to frame his questions so as to bring forth the testimony in its natural sequence and thus give to it the best effect possible. Of course, the line of inquiry he lays out will not be followed strictly in the cross examination, but it will be followed substantially, so that the direct examination can be used as a preparatory exercise for the really serious struggle that comes after. The accountant who dreads a cross examination can drive some of its terrors away if he will but bear in mind that the cross-examiner will not be permitted to ask a question which does not pertain to the testimony given on direct examination. This being the case, when the direct examination is concluded the witness knows what the subject-matter of the cross examination will be, and need not worry in anticipation of questions relating to extraneous matters. The witness should be careful to stop his testimony promptly when an objection is offered by the opposing counsel, as nothing is quite so irritating to a lawyer as to have the witness, in effect, overrule his objection by blurting out a reply before the court has had a chance to make a ruling. On cross examination the witness should always pause a moment before replying to interrogatories, in order to give the attorney, whose witness he is, an opportunity to offer objection, if he shall consider the question propounded to be subject to objection. Many accountants who have not been called upon to make legal investigations labor under the impression that when produced as witnesses they will be regarded as being wholly disinterested. This is an altogether mistaken idea. If an accountant is produced as a witness on behalf of one of the parties he may assure himself that the "other side" will regard him as distinctly hostile, and show him scant courtesy. He should have a consultation with the attorney for whom he is acting, in advance of the trial of the case, and inform him of the

exact nature of the testimony to be given, making it very plain that in no event will the witness stretch a point in his favor, or even leave a false impression of the facts to be related. Then, having the truth well in mind, the witness should tell it frankly and stick to it firmly. It is impossible for an accountant to be concerned in a legal investigation without becoming to a certain extent biased in favor of the party in whose behalf he has been engaged, so that it is very necessary indeed that every fact testified to be susceptible of absolute proof. It sometimes happens that an accountant, in an excess of loyalty to his client, goes too far in his testimony, and states as facts matters that are really opinions, with the result that the cross examination lays bare this condition; and all of the testimony given has a shadow of doubt thrown upon it, though it be as true as gospel. An accountant should never be disloyal or forget whose witness he is, while, on the other hand, he must remember that he owes no loyalty strong enough to justify him in deviating a hair's breadth from a simple statement of actual facts only. The principal reason for the dread accountants feel for the witness stand is a lack of familiarity with the administration of the law by the courts, which should be overcome by a course of reading covering the subjects of Evidence and Chancery Practice. It would be very helpful also if the attorneys would read up on the Theory of Accounts, and thus prepare themselves to intelligently examine an accountant produced as a witness. Legal investigations are among the most interesting, as they are among the most remunerative, engagements falling to the accountant's lot, and members of the profession should give this branch of the work especial attention, for in no other way can the legal fraternity be brought to understand that accountancy is an exact science of which they can in many ways make advantageous use.

NOT OVERCROWDED

You ask if we really "think the certified public accountant profession is an advisable one for a young man of nineteen to study; whether there are as many opportunities in it as there are in the medical or legal professions, and whether or not it would be liable to become profitable later on?" You also speak of having a natural taste for the work of an accountant.

We would advise a young man to enter any profession for which he has a distinct taste, or liking. A person is never attracted to a pursuit he cannot perform. Granting then that you are certain of your liking for this profession, we would certainly advise you to take it up, for there is every reason to suppose that the business of public accounting in this country is merely in its infancy. Though at present the profits in it are not as great, perhaps, for those of the head of the profession as they are in law or medicine, the possibilities of profits are very large and the opportunities much larger. Instead of being overcrowded the profession of C. P. A. is not crowded enough.

New and able men are needed in it. Large corporations in this country are seeing more and more the advantages to themselves of employing the services of experts, who make accounting their life work. The demand is constantly growing, as the complexity of industrial conditions increases, and this demand has to be supplied. In England, where the profession is older than in this country, but where the natural demand cannot ultimately be so great, there are two societies of expert accountants, with a membership roll of 5,000. In this country only about 800 or 900 can at present be accounted for. It is, therefore, reasonably certain that the profession is just "budding out," and a far-seeing young man would be wise to choose it.—Selected.

We hear much of the timidity of capital, but little of the boldness of poverty.

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The outlook for the profession of accountancy was never so good as at the present time. With the recognition on the part of the business community of the usefulness, and even necessity, of the accountant's services, is coming also the acknowledgment that such services deserve to be well compensated. With opportunities that are steadily becoming more numerous, and with a conceded privilege of exacting increased compensation, the conditions are such as to encourage an optimistic contemplation of the future. Apparently the only thing needful to bring about conditions that are thoroughly satisfactory is the moral courage to decline engagements that are offered at prices too low for serious consideration. There are some business men who need to be taught that there is no such thing as "fairly good" accounting service. It is either good or bad. No compromise in its quality is possible, and about the poorest investment that can be made is to be found in buying accounting service the reliability of which is subject to doubt. The experience and skill necessary to give good accounting service is entitled to earn good compensation, and members of the profession should

not need to be reminded of this fact. The individual accountant probably needs but little advice on this point so far as his personal service is concerned, but when it comes to making a choice between temporary idleness for an employe, and an engagement at figures representing much less than the value of his services, several heads of firms need to have their courage increased. It is equally as profitable to keep a man employed half the time at twice the pay as it is to keep him employed all the time at half the pay—and it discourages the "bargain-chasers."

By far the most interesting and important event of the year, viewed from an economic standpoint, is the stand **Government Control of Freight Rates.** taken by President Roosevelt in his message to Congress in favor of granting to the Interstate Commerce Commission the power to fix freight rates. This action, if taken, will bring about a condition of affairs that is not at all to the liking of the management of the so-called "community of interests" idea. The management of this "idea" have all along had in mind the equalization of freight rates by a general rise to a higher level, and any action that interferes with this beneficent purpose is destined to become very unpopular with these philanthropists. The president of one of the principal western roads recently took occasion to express the opinion that if the power be given to the Commission to fix rates, the result would be the elimination of competition and that, without the incentive of competition, the service given would deteriorate. This would be serious if it were proposed to prevent the railroads from making lower rates than those fixed by the Commission, but so far no one has been heard to favor any such plan. It seems to go without saying that no steps will be taken to prevent the quotation of lower rates than those fixed by the Commission as fair and reasonable, pro-

vided the rates quoted apply to all shippers of the same class of freight for a haul of the same length. What the President hopes to accomplish is such a regulation of rates as will give to the small shipper the same service on the same terms as is enjoyed by the large shipper, and if he succeeds he will have accomplished more for the good of the business interests of this country than any man who ever held his office. The chief trouble with the railroads of the United States is to be found in their fearful and wonderful capitalization, and began in most cases with their original construction. Instead of capitalizing a road for a sufficient amount of stock to build and equip it, if subscribed and paid up, the stock was used as a bonus to induce the underwriting of a bond issue sufficient in volume to produce the necessary funds. This underwriting was generally done by people who were willing to hazard the money of others entrusted to them for safekeeping, provided always the stock bonus was large enough to overcome their conscientious scruples. After this initial operation, there followed, in apparently natural sequence, other bond issues to pay for lines acquired by purchase, and for other purposes too numerous to mention, until finally the road was loaded with a capitalization including therein the bonded debt, so heavy that to meet interest on the bonds and pay dividends on the stock it became necessary to maintain freight rates that are unfair, unreasonable and unjust. Of course, the railroads want the public to look on the matter from their standpoint, namely, so much stock, so much bonds—so much dividends, so much interest. But the public doesn't sympathize much with those sleek fellows, sometimes called financiers, who manufacture securities with their own hands; on the contrary, the public is disposed to ignore the stock and bond talk and say: "Upon whatever sum of money is represented in the actual cost of construction and equip-

ment of your road, you are entitled to a fair return, but don't expect us to pay an income on from two to five times the amount of your actual investment." And the public is right.

The action proposed by the President as a solution of the rate problem was still the subject of lively newspaper discussion, when the report of Commissioner Garfield, of the Bureau of Corporations, was made public. This report, the first ever issued by the Bureau, proposed that corporations intending to transact a business of an interstate character be required to secure a license from the federal government, make regular reports of their affairs, and open their books to the Bureau whenever called upon so to do. Some of our "captains of industry" fairly snorted when the suggestions contained in this report became known. If there is one thing that, more than another, makes a "captain of industry" snort it is a suggestion that the public shall know something about a corporation whose stock it is solicited to buy. These "officers" would better get in line with good grace before they lose their shoulder straps. The American people have stood for "high finance," which, interpreted, means larceny, about as long as can be expected. Every man in the country who is not dependent upon some swollen corporation for his bread and milk, will applaud the suggestions of Commissioner Garfield. If honesty in corporate affairs can be had in no other way, it certainly should be compelled with all the power of the government. These "captains" who have secured their wealth and rank through depredations practised upon the unwary should be permitted to have no successors. There is ample opportunity for the acquisition of reasonable wealth by honest methods, and the public is as much entitled to protection from the chicanery and fraud which characterize the

Regulation of Corporations.

affairs of many corporations as from the enterprise of the more honorable though less pretentious gentlemen who wield the sand-bag in poorly lighted districts.

The much talked of Chadwick case, now that its details have been made public, compels both smiles and sympathy. The idea that experienced bankers could be induced to lend money on the security of the promissory note of a man known to be under no necessity of issuing bills payable, and known also to be much too wise to confirm a story reflecting on his own probity by placing his own notes of hand where they would thus operate, is really laughable, and if the bankers themselves were the only sufferers from their credulity, the public would do nothing else but laugh. However, it happens that the bankers were lending other people's money, and this fact causes the smile to fade, and a feeling of seriousness to succeed it. The directors and stockholders of these institutions, as they proceed to make good an assessment of one hundred per cent on the stock they held, will probably conclude that it would have been cheaper to have had the bank's affairs thoroughly audited before the wily woman had all its money. If the Chadwick swindle serves to put the banking interests of the country in the way of recognizing the necessity for independent examinations, it will be worth all it cost, for it is safe to say that no accountant of any standing would ever be fooled by such impossible "security."

A man should occasionally take an inventory of his principles; there may be a lot of depreciation that needs writing off.

When a prospective client says that if he "had the time he could do the job himself," he is uncommonly glad that time is so scarce.

EMBEZZLEMENTS

For the month ending January 11 the daily press reports 89 cases of embezzlement, classified as follows:

OCCUPATION.	NO. OF EMBEZZLEMENTS.		AMOUNT.
Bankers	14	\$	563,700.00
Government officials.	12		94,809.46
County officers.....	5		149,738.49
City officers.....	6		110,768.00
Officers of corporations	3		5,341.00
Officers of building associations	3		41,712.92
Lodge officers.....	6		13,685.29
Executors	2		2,400.00
Private secretaries...	2		33,500.00
Secretaries of labor unions	4		4,300.00
Mfrs'. agents.....	3		6,000.00
Bookkeepers and cashiers	29		188,755.08
Total	89	\$	1,214,710.24

The most striking circumstance connected with these embezzlements is not that the bankers absorbed such a high percentage of the total amount embezzled, but that but one occupation, in point of numbers, is more fully represented than the banking fraternity. The bookkeepers and cashiers represent every line of business, and naturally stand first in point of numbers. The county and city officers emphasize the necessity for better safeguards in public accounting. All of the occupations listed are of those holding positions of trust, and the exhibit ought to be sufficient to convince every reader of the great need for the adoption of regular audits as a part of the business policy of every concern where opportunities for embezzlement exist. It is safe to say that every undiscovered embezzler will be more largely in default next year than now, so it would be only prudence to have the auditing done now and smoke the rascals out.

JOHN J. WILLIAMS

The untimely death of John J. Williams, which occurred at San Francisco on December 30, deeply distressed his many friends in the Illinois Society of Certified Public Accountants, of which he was a Fellow, and brought sorrow to all who had been fortunate enough to enjoy his acquaintance.

Mr. Williams was born in Cheshire, England, in 1866 and was in the very prime of his useful life, when, in November, while engaged in conducting an investigation for the firm of which he was a member, he was stricken with typhoid fever, which, with subsequent complications, resulted in his death. Mr. Williams was a splendid type of the man who "does things." Of a modest and retiring disposition, he nevertheless so employed his abilities as to leave behind him a most creditable record of substantial accomplishments. For some years he served as auditor of the Calumet Electric Street Railway, leaving that important post to engage in business as a public accountant, for which he

seemed to have a natural aptitude. In 1899 he became a member of the firm of Reckitt, Reckitt & Williams, and from January, 1903, to the time of his death was a member of the firm of Wilkinson, Reckitt, Williams & Co.

In April, 1903, Mr. Williams was appointed by the United States Court receiver of Lord, Owen & Co., a large wholesale drug house, and his administration of this trust was so ably conducted as to bring him much praise from all parties concerned therein. Altogether it would be hard to find a man combining in a higher degree the qualities of professional fitness, good citizenship and loyal devotion to duty. Mr. Williams is survived by his widow, who faith-



fully watched at his bedside during the long weeks of his illness. His funeral was held from Trinity Reformed Episcopal Church, in Chicago, on January 6, and the attendance testified to the great esteem in which he was held by his neighbors, friends and professional associates.

THE WASHINGTON SOCIETY

To meet a distinguished member of the profession of public accountants, Hon. A. Lowes Dickinson, of New York and London, president of the Federation of Certified Public Accountants of the United States, members of the state board of accountancy and the Washington Society of Certified Accountants assembled in the smoking room of the Tacoma hotel last night, and a reception was held, followed by an informal discussion of matters of paramount importance to those present.

The state board was represented by L. G. Jackson, chairman; E. G. Shorrock, of Seattle, secretary; H. W. Carroll, of Seattle, and W. C. Chidester. The only absentee was F. P. Greene, of Spokane, who could not reach the city in time to be present at the meeting. The state society was represented by George Shedden, secretary; Fred Foster, G. W. Temple and others. Mr. Fred Foster, G. W. Temple and others. Mr. Chidester is president of the society.

To a representative of the *Ledger*, Mr. Dickinson stated that the organization of the public accountants of the United States into a national body would be perfected, in all probability, during the coming year. The federation of which he is president is a national organization, but there is another national association with headquarters in New York, and it is proposed to consolidate the two, thereby uniting the profession for the promotion of mutual interests.

"The profession of public accountancy is probably the least understood in the West of all the professions," said Mr. Dickinson. "I frequently hear people ask, 'What is a public accountant?' and the facetious answer has been given, 'Oh, a tramp bookkeeper.' Now, that is quite as ridiculous as it is unfair, because the profession of public accountancy is one that requires great technical skill, and is also one of the most useful professions in the world, without

exception. What can be of greater value to a business house, for instance, than that its accounts be correct, that the cost of production be known, that the earnings and profits and dividends be figured out systematically and easily? True, every well regulated business keeps a set of books and employs a bookkeeper, but without system in the conduct of a business even a bookkeeper cannot save it from ruination.

"A public accountant is a man who will perfect a system of bookkeeping, will devise methods of ascertaining at a glance the exact standing of the business man, both as debtor and creditor. In the operation of stock companies, for instance, a public accountant is a necessity. A certification of the financial standing of a concern, made by a public accountant, is worth more to a stockholder than all the statements submitted by the bookkeeper. The public accountant is not interested in the statement beyond the fact that he is engaged to prepare it. The idea prevails among many business men that to call in a public accountant to go over his books is to cast a reflection or suggest a suspicion concerning the ability and honesty of his bookkeeper. I consider the matter in a different light.

"No bookkeeper of sense, it seems to me, would resent the employment of an expert accountant to check him up from time to time, but as a matter of fact it is not an indication that the employer is losing faith in the employe if he does engage an accountant. The bookkeeper is there to keep books, while the accountant is engaged to devise a system or method of keeping the books that the business man may have a better understanding of his own business.

"There are other branches of business where the services of a public accountant are of great value, as, for instance, the set-

tlement of receivership accounts, bank accounts, failures and trustee's accounts.

"In the operation of a business where competition is very keen, say the lumber trade, it is necessary that the manufacturer work on a system that assures accuracy, and the public accountant is the man to call to his aid. In England the practitioner is known as a 'chartered' accountant, and every large business house makes it a point to submit its books to him at least once a year. In the United States business men are beginning to realize and recognize the value of the profession, and every year witnesses an increase in the number of business men, firms and corporations who adopt the system of having their books audited by a public accountant."—The Daily Ledger, Tacoma, Wash.

ADDED TO THE LIBRARY

The library of the Illinois Society of Certified Public Accountants is considerably richer since the receipt from Mr. Frederick S. Tipson, C. P. A., of copies of his well-known works on "The Theory of Accounts," "Auditing" and "Commercial Law." Mr. Tipson has performed a real service to all who are interested in these subjects by the preparation of these valuable works, which are regarded as standard by the universities now using them in their schools of commerce and accounts.

The literature of the accounting profession has been lamentably scarce and Mr. Tipson deserves much praise for giving his time and talents to this necessary but heretofore neglected work. The reading of these volumes will be of profit to the best accountant, while they are simply invaluable to the student.

To the true promoter all things are assets, and liabilities are figments of a diseased imagination.

OUR FRIENDS—THE FURNITURE MAKERS

Recently there has been an important addition to the ranks of the so-called accountants who combine with their profession the gentle art of manufacturing furniture. Apparently these manufacturers have an idea that it is only necessary to call themselves accountants to secure the patronage and confidence of the business community in their professional fitness. Fortunately business men who are capable of handling their own affairs are becoming much more difficult to impose upon in this connection, and the accountants who are not also furniture makers have every reason to expect that the campaign heretofore conducted by people who are trying to sell things has passed its flood tide of effectiveness and is now seriously on the wane. The wonder is that these people ever were able to impose upon the business public, since it should have been very apparent to men with even limited business experience that the proper man to consult as to what they needed in the way of office supplies, books and devices, was not one who was engaged as a salesman by a concern manufacturing the same.

SOME CHANGES

On January 1 the well-known firm of Walton, Joplin & Co. was dissolved by expiration of the partnership agreement. Mr. Seymour Walton has associated himself with Mr. W. H. Roberts, under the firm name of "Walton, Roberts & Co." Mr. J. Porter Joplin will give his attention to the considerable personal clientage with which he has so successfully surrounded himself, and will also represent in the West the firm of James Park & Co., of which he is a member.

The new firm of Walton, Roberts & Co. needs no introduction, as both members have been for a number of years engaged in the accounting business, with honor to the profession and profit to themselves.

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THE UNIVERSITY OF ILLINOIS

BY DAVID KINLEY, PH. D., DEAN OF THE COLLEGE OF LIBERAL ARTS.

The University of Illinois was founded by an act of the legislature, February 28, 1867, and opened to students March 2, 1868. For more than twenty years after its establishment the University made very little progress. The people of the State took slight interest in it and the appropriations made by the legislature were very small. The attendance of students varied little from year to year and did not average more than 350. In 1889, however, a forward movement in the history of the University began. Since that year the legislature has made generous appropriations for instruction and buildings: the attendance has increased, new departments and schools have been added, and the field of the work of the University has been greatly broadened.

About ten years ago the number on the faculty was 65 and the registration of students about 800. Now the faculty has increased in number to 400 and the enrollment of students is 3,800.

In 1896 the Chicago College of Pharmacy became the School of Pharmacy of

the University; in 1897 the Law School was established, the School of Music was organized, the Library School, formerly conducted at Armour Institute, Chicago, was transferred to the University, and the College of Physicians and Surgeons became the College of Medicine of the University. In 1901 the Illinois School of Dentistry was affiliated with the University.

From 1895 to date the Library, the Observatory, the Central Heating Station, the Mechanical, Electrical and Engineering Laboratories, the whole group of Agricultural Buildings, the Men's Gymnasium, the Woman's Building, and sundry others, have been added to the material equip-

ment of the University.

The University is divided into six colleges and five schools. These are the College of Literature and Arts, which is the liberal arts department of the University; the College of Engineering; the College of Science, in which the natural sciences are placed; the College of Agriculture; the College of Law, and the College of Medicine, located in Chicago. The



DAVID KINLEY, PH. D.

schools are Dentistry, Music, Library Science, Pharmacy and the Graduate School.

The College of Engineering, which is one of the strongest in the country, is highly regarded by engineers, manufacturers, and others, who are constantly calling for its graduates. The work of the College stands so high that there is no difficulty in placing its graduates from year to year, and places for more could easily be found. The College offers

year more than the whole appropriation made for the maintenance of the University. Among other things, the College devotes itself to the study of methods of reclamation of waste soils, the improvement of cattle, of seed corn, the dairy, and a large number of other lines of work.

The Colleges of Liberal Arts include the two already mentioned—the College of Literature and Arts and the College of Science. In these two colleges is offered all the work commonly included under the



LIBRARY BUILDING.

courses in architecture, architectural engineering, electrical engineering, civil engineering, railway engineering, and municipal and sanitary engineering. The equipment of the College is all modern and extensive.

The College of Agriculture has grown with remarkable rapidity in the past few years, and, in connection with the United States Experiment Station, is doing work which is attracting the attention of agricultural experts all over the world. The experiments and discoveries in the College of Agriculture return to the State each

name of liberal arts, beside certain lines of work which are of special interest, perhaps, to readers of *THE AUDITOR*. These lines of work are the so-called Courses of Training for Business, in the College of Literature and Arts, corresponding to what in some institutions is known as a school, or college, of commerce. The course of study laid down aims to fit young men for business life in various directions. In the words of the circular which describes the work: It is not expected that the University shall turn out graduates who are finished business men,

but rather graduates who are well trained mentally and morally and well informed in the fundamental principles that underlie all businesses. It is the belief of the University authorities that young men thus trained are able to develop in their business life, and to reach positions of responsibility and importance, far more rapidly and successfully than they would be likely to do without such training.

These courses at present include (1) the general business course; (2) a course in commerce and consular service; (3) a course in banking; (4) a course in transportation; (5) a course in insurance, and (6) a course in preparation for newspaper work.

The fundamental work in all of these courses is the same, and consists largely of economics, with adequate training in foreign languages, history, and other necessary subjects. Every student in these courses is required to study commercial geography, the principles of economics, the elements of monetary history, banking, of business organization, corporation management, finance and accounting, commercial law, and some foreign language. A proper amount of mathematics is required from students in courses where this is appropriate. In others it may be replaced with courses in philosophy, psychology and other subjects.

In the last two years of these courses each student is required to specialize intensely in one or two departments of the business he intends to enter, making himself thor-

oughly familiar, so far as can be done in an academic way, with all the methods and details of its organization and management. For example, if a young man is looking forward to the work of life insurance, he must decide by the end of his second year whether he wishes to take up the general work of insurance, the work of an actuary, or the ordinary field work, and his studies are directed accordingly. If he desires to go into the work of railroad transportation he takes all the courses in economics, a course in the economics of railway management, and then is required to indicate what department of railway work he wishes to specialize in. In the case of such students, certain semi-technical courses in engineering are required.

In all cases the work of the University is supplemented by talks from business men and visits to business establishments in operation.

No fully equipped course in accountancy is yet provided by the University. Students who enter the business courses are expected to be familiar with the general principles of bookkeeping, and are re-



CHEMICAL LABORATORY.

quired to take courses in corporation accounting and finance. They get practice in the analysis of railroad and other corporation reports, and are required to study commercial and corporation law, so that they get an all-round general knowledge of the fundamental principles of the whole subject. It is hoped that the way will be



ENGINEERING BUILDING.

opened before long to offer courses in the history and theory of accounts, and in practical accounting. At present, however, the University has no means of providing this work. Perhaps it is not too much to hope that the accountants of the State will interest themselves sufficiently to secure adequate means from the legislature for the establishment and carrying on of such work.

THE EDUCATION OF ACCOUNTANTS.

It is with some diffidence that I undertake to comply with the request of the editor to make suggestions about subjects in which expert accountants should be trained. I have recently sought the opinions of a large number of accountants concerning the proper sphere of the work and the duties of the accountant. The opinions differ so much that a layman may well ask to be excused from saying what subjects an accountant ought to know. With all due deference, however, to the opinions of expert accountants, I venture to make certain suggestions:

There are, of course, some subjects, an

acquaintance with which must be taken for granted at once. First and foremost, I would emphasize the ability to write and speak the mother tongue correctly. I emphasize this as the result of a somewhat extensive correspondence with accountants during the past two years. Besides this there are the subjects which constitute the heart of the accountant's work, like accounting, theoretical and practical, auditing and commercial law. In addition to these there are some subjects a knowledge of which is, in my judgment, essential to the successful practice of the accountant's profession.

I would specifically mention, first, a knowledge of political economy. This should include an acquaintance with the general principles of economics, together with such subjects as banking, the money market, credit and taxation. I can readily imagine cases in which a knowledge of all these subjects would be necessary to an accountant in active work.

Next in importance, perhaps, comes the study of business organization. By this is meant a study of the legal and administrative organization of a modern business-house. Some knowledge of corporations and corporation law is, of course, absolutely necessary.

Less directly connected with the accountant's work, but yet helpful, would be a knowledge of industrial and commercial history. Business methods change. The industrial character of a community changes sometimes pretty rapidly. If there is one thing more than another for which the professional economist finds grounds for criticising the so-called man of affairs, it is his ultra conservatism; his apparent belief that the present industrial order is something that has existed from the beginning and will endure to the end. This may seem a strange remark in view of the fact that the business man is usually regarded as ready to adopt any new method

that will be an improvement upon the old one. There is a common readiness to adopt new methods of detail, but a very great conservatism as to general fundamental organization.

A knowledge of one or two foreign languages is also helpful. The use of such knowledge is, of course, obvious, if accountants are to be called upon to do work that has foreign connections.

Aside from these subjects, there is, of course, the so-called liberal education, which comes from a study of history, art, literature and politics. I need not urge, of course, the necessity for such study by would-be accountants as will make them intelligent citizens. An accountant should be able to talk intelligently about such topics of the day as railway rates, the labor problem, banking reform, etc.

I presume that my friends, the accountants, will think this is a pretty large program. They will find, however, that as their work rises in dignity to the plane of a profession it will have to rest, as other

professions rest, upon a broad foundation of liberal education, and that it will have to be in close touch with a great many subjects of human interest and human study that do not directly contribute to its monetary success. The passage of the Illinois law regulating the profession of accountancy was a great step in advance. The University has honestly tried to administer this law fairly and in the interests of the profession, while conserving the interests of all individuals concerned. The University looks to its new body of degree holders for the support that it naturally expects from all its graduates. It hopes for not only the inspiration and enthusiasm that their loyalty arouses, but for the more practical and material help that it needs so often when seeking its appropriations, or when trying in other ways to develop its resources to meet the growing needs of our great State for higher standards of education and broader courses of study. I am sure that it will not look to the accountants for such help in vain.

THE DUTIES OF PROFESSIONAL ACCOUNTANTS IN CONNECTION WITH INVESTED CAPITAL BOTH PRIOR TO AND SUBSEQUENT TO THE INVESTMENT

BY FRANCIS W. PIXLEY, F. C. A., BARRISTER-AT-LAW.

(Continued from January Issue.)

Although not actually a case in point, it may be interesting to state that it has also been considered most unprofessional for an English chartered accountant to give a certificate of profits made by the clients of advertising brokers in connection with their speculations in certain securities. These certificates are made use of to entrap the inexperienced, and as they contain no reference to the losses sustained by these clients, and by other clients gambling in other stocks—in other words, as they do not deal with the

whole of the transactions of the brokers with all their clients, but only with certain selected ones—they cannot be looked upon as straightforward certificates, and the use of them is calculated, looking at it from the lowest point of view, to bring the certificates of professional accountants as a class into disrepute.

A professional accountant, before putting his client to the expense of an investigation of the accounts of a concern which it is intended to offer for sale to a public company, should ascertain that the accounts have been

so kept that it will be possible for him to give the required certificate when his work is finished. No matter how well the books of a large trading concern have been kept, it is impossible to ascertain the amount of actual annual profit for a series of years if it has not been the custom of the proprietors to have taken a correct account of stock in trade at the end of each of these years. Instead of being able to certify to the profit of each of the last four or five years, as desired by the promoter, the accountant could not do more than give a certificate of the sales of each year, from which the proposed directors could, if they cared to take the responsibility, state in the prospectus what has been the probable profit on this turnover. In many instances a promoter would not care to run the risk of endeavoring to float a company without a certificate of actual profits from the accountant, and where early in the proceedings the accountant ascertains he will not be able to certify as required, he should at once inform his client, and give him an opportunity of considering his position.

I have mentioned these few examples with the object of giving what I know to be the views of some of the leading professional accountants in England as to their moral responsibilities, and I feel sure that you will not disagree with them, or wish for a lower professional standard to exist on this side of the Atlantic.

In an address to such a distinguished gathering of trained accountants I shall not, of course, presume to indicate how, so far as details are concerned, should be conducted an examination of the accounts of any concern for the purpose of ascertaining as to whether or not it may be a desirable one for the investment of capital, but on behalf of those of less experience, and for students, I may state that so long ago as February, 1890, I had the honor, on the invitation of the Chartered Accountants Students' Society of Edinburgh, and the Glasgow Insti-

tute of Accountants' Debating Society to read a paper on consecutive evenings in Edinburgh and Glasgow, on "The Investigation of Accounts of Commercial Undertakings Previous to Their Conversion into Public Companies," in which paper I went very fully into the details of the conduct of an examination of this nature. This paper was published,* together with a number of my other addresses, in 1897, and can be obtained by students and others who care to study such details.

You will, however, I feel sure, not consider me guilty of presumption in referring to a few special items intended more to illustrate the principle on which investigations of this nature should be conducted than an attempt to in any way teach those whose experience may be as great, or even greater, than my own.

In the first place I cannot impress upon you too strongly the desirability of taking very full notes, not only of the details of the investigation itself, but also of interviews with your client, the directors of the proposed company, the solicitors, valuers, and anyone else concerned. These notes will, of course, include instructions received, any suggestions you may make thereon, and generally any advice you may deem it desirable to give. It is possible these notes may never be required, but it is quite possible they may be of the greatest importance in the future, more especially if later on the enterprise may prove unsuccessful, and you are called upon to explain your connection with it previous to and at the time of its inception.

A complete list of the books of account kept by the proprietor of the business should be furnished to the accountant previous to his investigation being commenced (and this he should, of course, retain, making note of those he examines), and a list of any papers made use of by him during his investigation should also be preserved.

*The Profession of a Chartered Accountant and Other Lectures." London: H. Good & Son, 1897.

Should any attempt be made to deceive the investigating accountant, it will probably be in one of the following ways:

(1) The omission of liabilities which ought to be charged against the profit and loss account.

(2) The inclusion among revenue of income not strictly applicable to the period under review.

(3) The overvaluation of unquoted securities, with the consequent result that certain losses are improperly omitted to be charged against the profit and loss account.

(4) The non-allowance for depreciation of fixed or partly fixed assets, or for losses likely to be incurred on the realization of liquid assets.

As regards the omission of liabilities, the difficulties of detection where such omissions are made deliberately may prove quite impossible to grapple with. In an investigation I conducted many years ago, the manager of a provincial fire insurance company conceived the idea of making it into a larger concern, with its headquarters in London, and at the same time increasing its subscribed and paid-up capital. As a result of my investigation I reported favorably, the scheme was carried out, and all went satisfactorily for nearly a year, when I was requested to meet the board of directors, when they informed me that they were utterly unable to understand the extraordinary number of claims which were coming in from a certain foreign country, and they gave me instructions to make a complete investigation of the affairs of the company. As a result, it was discovered that, previous to my investigation, arrangements had been made with persons abroad to hold back certain claims in respect to fires which had taken place, on the ground that they would be unable to be met, or some such reason. I can only imagine the claimants were told of the proposed scheme and consented to be a party to what followed, for claims in respect of fires which took place before the

incorporation of the new company were brought forward as new ones. At the time of my first investigation there was not a single document in the office and nothing in the books of account or letter books, which could show that such claims had ever been made, and the directors, fortunately for me, being men of business, never attempted to fix the slightest blame upon me for not having discovered what was practically an impossibility. At the same time, it was a lesson to me, and I now make use of it as an example of the care that has to be exercised by an accountant in investigations of this nature. Intentional omissions of this sort can, of course, be occasionally detected by comparing transactions of former years with those of the years under review, and, of course, the greater the experience an accountant may have of the accounts of business of a nature similar to the one he is investigating, the more likely he is to detect any omissions. In every investigation of this kind, it is distinctly part of the accountant's duties to endeavor to compare the percentage of gross profit made on the sales or turnover of a business for a period of years, and if the gross profit for the period he is asked to certify is above the average of preceding years, and the reason cannot be satisfactorily explained, then it is most necessary that he should endeavor by any means in his power to ascertain that all the purchases and changes have been brought into account. This may require great tact and judgment, as he must pursue his inquiries without any person either connected with or outside the business having any ground for suspicion as to why the special inquiries are being made.

The inclusion in the revenue of income not strictly applicable to the period under review is also another method by which the profit of a business may be unduly swelled, and where the profits of several years are set out for the purpose, perhaps, of showing that the business has been an improving one,

it is most important that the certifying accountant shall ascertain that the actual income of each year is brought to credit in its proper year. Where also the whole of the business is not to be sold, and part is to be retained in the hands of the existing owner, then, of course, care must be taken that the certified profits do not include any portion of the income which appertains to that part of the business not to be acquired by the purchaser.

The over-valuation of assets, so far as it affects the profit and loss account, is also of importance, stock in trade in the case of a trading company, land or houses in the case of a property company, or investments in the case of a finance company, requiring special attention. The value placed upon the stock in trade in a profit and loss account and balance sheet is at all times an unsatisfactory item from an accountant's point of view. When certifying as an auditor the accounts of a joint stock company registered under the English law an accountant is usually careful to explain in his certificate or report that the value of the stock has been taken, either at cost price, or that the value is certified to by some official of the company, but even then he deems it his duty to satisfy his own mind that the amount taken credit for is a proper one. In the case of certifying as to profits for the information of an intending investor, more care than this is requisite, as the accountant is here dealing with the stock in trade, not of those concerned in the future of the company, or to a certain extent responsible to a body of existing shareholders, as are the directors or managers, but he is dealing with the stock in trade of a concern which is about to pass wholly, or, at any rate, partly, into the hands of strangers, and he has to do his best to insure that the figure he is going to make use of will not unduly swell the profits he certifies. As already stated, however, I am not attempting here to teach you, but merely to call your atten-

tion to points demanding special inquiry, and I will not pursue this point further. The same remark applies to investments and property of other description, which may be brought to credit in a balance sheet, and consequently affect the profit and loss account.

The last of the four points referred to by me in connection with which an investigating accountant may be intentionally deceived is the non-allowance for depreciation of fixed or partly fixed assets, or for losses likely to arise on the realization of liquid assets. It is now generally admitted, not only by professional accountants, but by the financial and commercial world generally, that depreciation of wasting assets is as much a charge against revenue before arriving at the net profits as is money expended in wages, rent, or any other charges connected with a business. At the present time there is no fixed scale laid down for arriving at the proper amount to be charged for depreciation in respect of the many varieties or classes of wasting assets which can be met with. There is, however, one exception. All are agreed that in the case of leasehold property of every description there must be an amount charged periodically against the value of the lease so that at its expiration the capital money expended on its original purchase must in some way or other have been made good. Here again, however, there is a difficulty, as during the course of a long lease it by no means follows that auditors and their clients will agree as to the amount to be written off for each individual year of the lease's existence. When an auditor wishes to make this a fixed sum, extending over the whole course of years, he is frequently met with the argument, which in many cases is a perfectly correct one, more especially in a city like London, and other centers where property is gradually increasing in value, that a lease after many years has expired is worth more than it was when originally purchased. In the

case of deciding the amount to be written off leases, nearly every individual lease has practically to be separately dealt with.

As regards plant, machinery, fixtures and assets of this description, there is no fixed rule, and in an investigation such as we are considering, the accountant must satisfy himself to the best of his ability that a full amount has been charged against the profit and loss account, having regard to the special nature of the assets he may have to deal with. As a rule, when a business having assets of this description is taken over by a company a valuer is employed, who gives a certificate to be made use of in the prospectus, and the accountant must make as much use as possible of the valuer's knowledge in fixing the depreciation to be charged.

As regards loss likely to arise on the realization of liquid assets, such as book debts, whether on bills receivable or on open account, and on balances in the hands of agents or travelers, the professional accountant can only be guided by a careful examination of the age of these debts, and the experience of the past as to the manner in which they are usually discharged, and in the case of debts of any special magnitude, perhaps by means of a special inquiry.

You will notice that in these remarks I have referred solely to assets from the profit and loss account point of view, as it is very seldom that for prospectus purposes the accountant is required to certify beyond the profit earned. Balance sheets, as a rule, are not referred to, in consequence of the proposed alteration in the capital, and the fact that frequently many of the assets—such as book debts, investments, or cash—are not taken over. Those assets taken over are, as a rule, not acquired at the price they appear in the books, but on the valuation of the valuer already referred to.

It frequently happens that interest on loans forms a considerable portion of the charges against the profits of a concern pro-

posed to be converted into a joint stock company, in which case the accountant may be asked to omit this interest and add to it the profits certified, on the ground that the new company will have sufficient capital to render loans unnecessary in future. Now, to this request no exception need be taken, provided the accountant certifies that the profit is arrived at before such interest is charged, and has in addition satisfied himself that the capital proposed to be offered for subscription will be sufficient for the future working of the business on the same scale. To give his certificate without fully ascertaining that this will be the case would be most improper, and render him liable to be accused of participating in a fraud on intending subscribers.

When the accountant has completed his investigation on behalf of a private client, and has handed to him his report, his work is practically completed, and his client can come to a decision as to whether he will or will not invest his capital in the undertaking, but when the accountant has made his report to the intending promoter of a company to be formed to acquire the concern whose accounts he has just investigated, it by no means follows that his work is over. He may be prepared to certify to a certain amount of profits, but these profits may not be sufficient to show the amount requisite to pay the minimum dividend on the capital of the proposed new company, which, in the opinion of the promoter, he must put forward in order to obtain the requisite capital. It is in a circumstance like this that strength of character is required, as great pressure is frequently put upon the accountant to induce him to alter his figures, and show at least the minimum profit required by the promoter to make his prospectus attractive. Various arguments are adduced, such as that too much allowance has been made for loss likely to arise on realization of debts; that too much depreciation has been written off the leases or plant and ma-

clinery; or that certain expenditure has been charged against the last year's profit which might properly be spread over a term of years.

Now, it by no means follows that some of the arguments are not sound, and it is quite possible the accountant may see his way to amend some of his figures, but he must only do so on being absolutely convinced of the propriety of so doing, and he must not yield to persuasions based on any other ground. One of the most common arguments put forth by a promoter in this unpleasant situation is that unless the accountant adopts his view the company cannot be launched, and all the expenditure which he has incurred to date, or for which he has made himself responsible, will be lost. I need scarcely add this is absolutely not worthy of any consideration by the accountant, who, although paid by the promoter, has not him to think of. The accountant's sole duty is toward those unknown persons who might be induced by means of this certificate to embark their capital in a venture which they would not do were the accountant to remain firm, and resist any temptation which may be offered to him to give a certificate which he does not consider true and unimpeachable in every respect.

I will now proceed to deal with the second part of my subject, namely, the duties of professional accountants toward the owners of invested capital, in other words, the duties of auditors.

Although, as previously stated, the duties of professional accountants in the United Kingdom embrace those appertaining to the holding of a number of official appointments, yet it is concurrently with the rapid increase of joint stock enterprises that the profession has advanced, and the real mainstay of professional work is the audit of accounts of companies and associations registered under the various companies' acts. At the same time there is also, I am pleased to add, a

gradual and steady increase in the number of private individuals, firms and others, who place not only their business books, but also those relating to their private affairs, in the hands of auditors. It has also become the most invariable practice for executors and trustees under wills to place the books containing the administration of the estates of their respective testators in the hands of professional accountants, not only in their own interests, but for the satisfaction of those who are beneficially interested in the testator's estate. Indeed, it was decided by our English law courts as long ago as 1818 that an executor or trustee may, if the accounts be complicated, employ a professional accountant to adjust and settle them, and to charge the trust estate with the fee under the head of "Expenses."

In 1844 the British Parliament passed an act providing for the registration, incorporation and regulation of joint stock companies. This was practically the first joint stock companies act, as previous to that date joint stock associations were, in England, subject to the law which governed ordinary partnerships of two or three persons. It contained very full clauses, providing for the proper keeping of accounts, the balancing of books of account, the preparation of a balance sheet and the audit of the same. From that period, however, up to the present time, notwithstanding the fact that later acts, including the companies' act of 1862, which was the first act constituting what is now known as limited liability, omitted all reference to auditors, with the exception of some clauses contained in a schedule to the act, which was only binding on those companies registered without special articles of association. The accounts of joint stock companies have always, as a matter of practice, been audited before being placed before shareholders at their annual or periodical meetings.

(To be continued.)

ON THE IMPORTANCE OF APPRAISEMENTS

BY WALTER W. POLLOCK, OF THE MANUFACTURERS' APPRAISAL COMPANY.

For accounting purposes the average manufacturer regards the tools which make up his manufacturing plant as of comparatively small value and importance. He possibly may have records of the original costs of buildings and equipment, from which for years he has been estimating or guessing off depreciation, possibly at the same time charging repairs and betterments to expense. The result is likely to be that in the confusion of charge and counter-charge he has lost track of the true value of his plant at the present time. He may be willing, for proper and conservative reasons, that his buildings and mechanical equipment should financially stand at zero. He does not want to fool himself by valuations upon his plant that he cannot fully justify to stockholders. The only occasions for consideration of any other than a conservative value, in his opinion, are when he comes to put a price upon his plant for sale, either to a proposed combination or to the insurance companies in the event of fire. Then his former statements of value are found to be worthless. The depreciated valuations as given in his ledger do not show what his plant is worth as "a going concern." Neither do the books show, in total or in detail, what

he would be entitled to receive from the insurance companies in the event of fire. He has carried his plant on his books at a conservative price, which bears merely an approximate relation to the true value. He has every year placed a stated amount

of insurance by guesswork, without fully realizing the fine-type obligations of his policies or the obligations of the co-insurance clause rider, which, in the event of under-insurance, may nullify in a large measure the protection that he had supposed that the payment of insurance premiums gave him.

APPRAISALS AND FIRE INSURANCE.

In the past five years many manufacturers, realizing the importance of



WALTER W. POLLOCK.

accurate knowledge concerning the true value of their plants, have employed disinterested appraisal companies to furnish them with detailed appraisements of their plants. Some of the appraisements have been crude as to system and imperfect as to the application of the system; but in any event the employment of a disinterested appraiser has been of important assistance in determining the value of manufacturing plants.

The most easily proven worth to a manufacturer of a disinterested valuation is in connection with the placing of insur-

ance and the proof of loss after a fire. At the same time a properly made appraisal is valuable for any purpose that may arise, in which a correct inventory and valuation may be required. Bankers usually extend credit to manufacturers more on account of reputation and financial standing than because of the physical value of their plants; but instances could be cited where disinterested plant appraisements have enabled the increase of lines of credit where all other means had failed. In appraisal companies which have a reputation for accuracy and good faith to maintain, receivers, assignees and trustees have a means of protecting themselves as well as those whom they represent at small expense and with a far more accurate knowledge concerning the property in their hands than could otherwise be obtained.

In the making of audits accountants have been accustomed to use the book values in arriving at the worth of a plant. In some instances the owners have deducted so much for depreciation that their books do not show the truth, or more than a semblance of it; and the owner does not get as favorable a showing as he is entitled to. In plants where the work is divided into departments it is important in making up factory costs to know the actual amount of capital invested in each department. From such a record it is possible to figure proportionate amounts of non-productive expense, such as heat, light, clerk hire, insurance, taxes, etc. Partners and other officers sometimes disagree, and then the services of a disinterested appraiser are invaluable in adjusting such differences. There are a number of other contingencies which will readily suggest themselves, under which a disinterested appraisal would be likely to prove of great value and importance.

It is only within the last year or two that an appraisal system has been perfected that covers the entire ground of the

requirements of manufacturers. It may be said without fear of successful contradiction that the best appraisal system is that which shows the largest amount of detail, with the various items arranged and grouped in the most comprehensive manner; that can be most easily checked against the individual items; and that by reason of accuracy of descriptions and valuations best enables the reproduction of the portions destroyed in case of fire. Manufacturers who have been accustomed to having their inventories taken by their own employes have frequently found their confidence in the work of these employes misplaced. There are hundreds of questions that will arise in appraising a large plant that can only be properly transferred to a written record by the expert, trained appraiser. In one large plant, for instance, the machine shop superintendent directed three of his mechanics to inventory the tools, and found as a result that a certain tool in common use had three different names, none of which was the correct catalogue description. The names assigned to this tool were shop slang names, and the identification of the tool by the maker's catalogue was most difficult, not to say impossible, to anyone not familiar with the shop. In appraising the equipment at a number of plants owned by several large concerns which recently combined, expert appraisers were asked to check over the inventories previously made by the local employes. The invariable result was the finding of from 25 per cent to 50 per cent increased value. There were both omissions, errors of arrangement, wrong descriptions and wrong prices, all due not so much to carelessness on the part of the original makers of the inventories as to the lack of experience in appraisal making.

The approved disinterested appraisal system, as perfected by companies engaged in

the business of valuing property, now consists of the following features:

First: Piece bills or bills of quantities of materials used in the construction of each building, such piece bills showing the locations by floors and the values of all materials as installed in the building. The piece bills show separate items for flooring, partitions and for all other construction materials, so that the actual property destroyed, and its value, can be easily determined and located.

Second: Complete classified lists of all equipment, such as machinery, shafting, pulleys, belting, tools, pipe and fittings, galvanized iron pipe, electrical apparatus, laboratory equipment, patterns, dies, trucks, scales, office furniture and fixtures, and benches, tables, racks and cupboards; and when all property that is classifiable has been listed there should be a miscellaneous list of small and insignificant items, the aggregate value of which is usually unexpectedly large.

Third: In verification, complete sets of factory plans are made, showing: A general map of the property, indicating property lines, street lines, railroad tracks, underground pipe, fire hydrants, the location, size and number or designation of each building and all features that pertain to the plant as a whole; floor plans, locating all machinery, power transmission, office partitions, office fixtures, and other important mechanical equipment; cross sections showing the architectural construction of buildings, which are intended to verify the piece bills and corroborate the values shown therein.

CLASSIFICATION AND DEPRECIATION.

The appraisalment, to be serviceable to the manufacturer, should have all of this information correctly grouped, showing the totals of classifications for each building and should be summarized so as to show the actual and insurable values. In carrying insurance it is important to know

the approximate percentages of depreciation to be deducted as provided by insurance policy conditions, and also the total of the uninsurable and indestructible portions, such as excavation, foundations and underground pipe. This will enable the manager to place insurance so as to be fully protected, so as to comply with co-insurance requirements in the policy, and absolutely to prove loss in the event of fire by an appraisalment made when everything can be found and properly inventoried and described.

The question of depreciation is necessarily one of opinion. The correct basis of depreciation is the condition of the plant rather than the age. It is conceivable that a building or machine ten years old might be as good as new. It is also conceivable that a building or machine only one year old might require the deduction of a large amount of depreciation. It is therefore the duty of the expert appraiser (who in his work must become thoroughly familiar with every feature of the plant), to apply a rate of depreciation based on the condition of the plant as he sees it. Under any circumstances it is difficult to disprove a depreciated valuation made under these circumstances, provided it is made by an appraiser of intelligence and experience.

In the disinterested appraisalment the entire plant is first valued on the basis of what it would cost new, at present market values of materials, equipment, and labor required to place it all in position. From this new cost of reproduction (which is always the starting point in the adjustment of a fire loss), percentages of depreciation are deducted, thus arriving at the net present value for comparison with books of account. The insurable value is this depreciated value, less excavation, foundations and underground pipe, which are nearly always eliminated by the insurance forms. With a statement made in this

way the manufacturer knows whether or not he is a co-insurer and can prove his position by a disinterested valuation which is proof of its own accuracy.

APPRAISAL AND INSURANCE COMPANIES.

Legitimate insurance companies do not and cannot object to the manufacturer putting himself in a position to comply with insurance policy conditions, enabling him to prove his loss in complete detail. The point of view taken by appraisal companies is that insurance companies pay losses that can be proven; that any difference with insurance companies is due to the neglect of the insured in not fully understanding his obligations and carefully preparing to assume them when the fire shall occur. As a matter of fact, larger lines of insurance are carried by concerns whose plants have not been appraised, because of their belief in their ability to prove losses in detail.

Eventually the appraisal business will probably develop in a great many new di-

rections. The work of appraising manufacturing plants has for several years past been extensively carried on; the business has already extended to the appraisal of store fixtures and household furniture, and eventually it is likely that insurance companies will insist on disinterested appraisements of large plants before accepting insurance thereon. Possibly in time the appraisal companies will act as arbitrators in the settlement of fire losses, the proof of which will be made up from the duplicate records on file in the office of the appraisal company. It is also likely that expert accountants in completing audits will in time come to the point of requiring disinterested appraisements before accepting the book values of a plant. Under any circumstances I believe I am justified in saying that the appraisal business is now a permanent feature of the business life of the United States, and that it will have a constantly increasing clientele among progressive business men in all parts of the country.

MISCELLANY

MILLIONS EMBEZZLED.

Ten million dollars were embezzled in the United States during the year 1904, according to a statement just compiled by the Fidelity & Casualty Company of this city. These figures were regular straight out steals, followed by confession or conviction or by the disappearance of the guilty one.

New York state headed the list with the embezzlement amounting to \$1,851,585. California was next with a total of \$1,058,825. Then came Pennsylvania with the snug sum of \$987,233. Ohio followed with \$830,208. The other states in their order were: Iowa, \$677,782; Massachusetts, \$644,067; Missouri, \$492,003; Indiana, \$410,337; Illinois, \$400,832;

Texas, \$258,000; Tennessee, \$246,618; New Jersey, \$233,896; North Carolina, \$230,750; Connecticut, \$108,598; New Hampshire, \$164,884; Kansas, \$160,497; District of Columbia, \$122,076; Maryland, \$107,730; Indian Territory, \$106,751; Arkansas, \$97,500; Georgia, \$95,162; Kentucky, \$87,977; Louisiana, \$79,094; Minnesota, \$65,618; Michigan, \$51,189; Oklahoma, \$46,752; Colorado, \$42,050; Washington, \$38,000; Arizona, \$38,000; Virginia, \$31,153; Florida, \$28,760; Alabama, \$23,478; Maine, \$23,200; Alaska, \$22,500; Mississippi, \$18,240; South Carolina, \$15,000; Nebraska, \$14,800; New Mexico, \$12,700; Rhode Island, \$12,617; South Dakota, \$12,000; Vermont, \$11,800; Mon-

tana, \$11,357; Utah, \$11,030; West Virginia, \$11,000; Wisconsin, \$9,998; Delaware, \$6,200; South Dakota \$2,000.

The amount embezzled per capita was greatest in California where the rate was \$1.28 per 1,000 of population. The best state was Wisconsin, where the stealings average only 1-100 of 1 per cent of population.

A LITTLE GAME OF DRAW.

BY SEYMOUR WALTON, A. B., C. P. A.

Poker has been called our national game. It would be difficult to determine to what an extent this is true, but it would seem not to be much of an exaggeration when we think how many of its terms are constantly on our lips. A great politician advises his party to "stand pat," and does not find it necessary to explain his meaning. The mayor of our second city writes an article for a prominent periodical about "four flushing" in legislation, confident that nearly everyone will understand his analogy. At almost every turn we meet such expressions with no attempt at explanation, for none is needed.

This is not a sermon on the wickedness of gambling. The morality of poker may be left to the individual conscience of each man as far as that man is individually concerned. But there is a phase of the subject that is very often brought to the attention of the public accountant and that does not seem to be sufficiently considered by the average business man; the influence of the game on the young men who are in positions of responsibility. When the accountant discovers defalcations in the accounts he is examining, he knows almost to a certainty that they are caused by poker or some other form of gambling. The young men in charge of cash or in other positions of trust have heard their friends talking of the money won in these "little games," have overheard their employers

making an appointment for "a quiet session," have perhaps filed in their cabinets letters referring to a proposed game. They hear only of the winnings, seldom of the losses, and when they are requested to "sit in" some evening, they feel justified in doing what everyone else does, and they take the first step in what may be their downward career. It is, of course, not true that every young man who plays a "gentleman's game" is on the high road to ruin, but it is true that he is placing himself in very dangerous proximity to the entrance to it. The steps are too familiar to need more than passing mention. A bad run of luck exhausts the player's own resources, he "borrows" of his employer with the expectation of soon winning enough to repay him and at the same time to put himself in funds to continue his game. Further ill luck leads to further loans from the unconscious employer, until the unfortunate young man is so deeply in the toils that he becomes reckless and attempts to recoup his losses by deeper plunges or by speculation on the Stock Exchange, ending at last in disgrace and ruin.

We see a few of these cases mentioned in the newspapers, but every accountant knows that only a very small fraction of the defalcations is ever made public. There are men walking the streets of our large cities to-day who have been defaulters for very large amounts and no one knows a word of it except themselves, their employers and some accountant. There are various reasons for keeping such things quiet, reasons good or bad, with which we are not now concerned, but the fact remains that they are operative in about ninety-five per cent of the cases.

As every business man is obliged to trust his employes to a greater or less extent, it becomes a matter of importance to locate the responsibility for this condition of affairs. It is easy to blame the poor misguided fool who allows himself to be drawn

into the net that will eventually close around him, but those who know the circumstances best know that he is often more to be pitied for his weakness than blamed for his crime. He is usually young and easily led and does not often realize the tendency of his acts. He is accustomed to look upon his employer as a man whose example is to be followed if his success is to be duplicated, and he has not always the acumen necessary to distinguish between the desirable features of the example before him and those which are more valuable as danger signals than as guides.

The mature man of business has no such excuses for his actions. He knows perfectly well what he is doing and deliberately indulges in a pastime which entails on him consequences that he can afford to ignore, but which also places him in a very unfortunate light before those who are more or less affected by his example. His employes are sure to know his habits and to reason that if he can retain his position in the business and social world in spite of them, there will be no very great harm if they follow in his footsteps.

The business world has decided that it has little use for even the occasional drinker, and it is no longer good form to invite a new acquaintance to the nearest saloon to confirm an introduction. It is far more important that the business man should frown upon every form of gambling, and the first step is to see to it that he is not himself setting a bad example. Let him refrain from any form of card playing for stakes, however small, from betting on horse races or ball games, as well as from all kinds of speculation on the Stock Exchange and the Board of Trade, and he will have the satisfaction of knowing that his example is not leading astray any young man who is accustomed to looking up to him as a person whose actions are to be imitated. If he is at all the right kind of a man, this satisfaction will far outweigh the loss of the

little excitement gained by having a personal interest in the game that he is playing or the race that he is witnessing.

OLD-FASHIONED METHODS NOT PECULIAR TO ENGLAND.

There has been a good deal said lately about the difficulty of introducing new methods into English offices and factories, much of which is doubtless true. Insular pride, old-fogyism and other epithets are freely indulged in by American writers and speakers to designate the reluctance of our British cousins to rush into new and untried paths. From their remarks it would be inferred that this condition was peculiar to England, and that in America every office and every factory was up to date in all respects, that labor-saving devices had but to be invented to meet universal acceptance, and that the visitor most cordially welcomed by the merchant or manufacturer was the man who came to show him how to improve his methods.

Accountants know how far this is from being the true condition of affairs. Where one man welcomes suggestions in regard to his office methods, there are scores who are content to continue in the time-hallowed ruts, journalizing their sales and doing other antique things simply because they have always done them.

If you ask such men why it is that England has, to a certain extent, lost her command of the world markets, they will be quick to tell you that it is on account of her refusal to adopt modern scientific methods in office and factory; but while condemning her slowness in sweeping terms they do not seem able to realize that they themselves are guilty of the same shortsightedness to at least a limited degree. Just as England allows us to invade its markets on account of our better methods, these merchants and manufacturers are allowing their competitors to gain an advantage over them by reason of the modern systems of accounts

that enable them to ascertain the information in regard to their business operations that is vital to their success. Old-fogyism is not confined to England, by any means, and it is not less deadly in its results to the individual when it happens to be American instead of British.

When an old-established house fails the reason usually given is that it had been unable to compete with younger concerns. A critical analysis would show that the younger houses had a clearer grasp of their business through more perfect cost systems and other methods that gave them accurate information through which they were enabled to stop leaks or to develop lines that were profitable, leaving the unprofitable ones to the older concerns that had no such knowledge.

In old days we used to think a great deal of the rule of three in arithmetic. Following that ancient rule we can express the situation as follows, and ask our slow-going American to solve the problem:

As American enterprise is to British conservatism, so is the scientific method of the up-to-date man to the crudities of his old-fashioned competitor. If the latter fails to find a satisfactory answer, he will be wise to consult a certified accountant to work out a better one for him. If he does not, the probability is that the answer will be eventually read to him by the sheriff.

THE GLASGOW MEETING.

On the 15th of March the Institute of Accountants and Actuaries in Glasgow will celebrate the fiftieth anniversary of the grant to the organization of a royal charter. Invitations have been received by the various societies in America to appoint representatives to attend the meeting. The Illinois society has appointed a representative who fully expects to be in attendance, and THE AUDITOR anticipates from him a very faithful report of the proceedings,

which will reach our readers through the April number. The growth of public accountancy in Great Britain has been so considerable, even in the face of a conservatism that sometimes seems to actually oppose progress, that American accountants have every reason to hope and believe that on the fiftieth anniversary of the passage of the first C. P. A. law in the United States the profession will be as firmly established and as fully recognized as are those of law, medicine, engineering or architecture. At that time there will probably be engaged in the practice of our profession, within the territory of the United States, not less than 50,000 men. This prospect, which is not overdrawn, but which is rendered wholly probable by the experience of our British cousins, should be an inspiration to those of us who will hereafter be regarded as the pioneers of the profession. From the work already done we are justified in the opinion that the interests of the profession are in safe hands, and that future generations of accountants will properly appreciate the work now being done by the "pioneers."

WILKINSON, RECKITT, WILLIAMS & CO.

Announcements have been received stating that this well-known firm will continue under its old name, the partners being George Wilkinson, C. P. A., and Ernest Reckitt, C. P. A. The announcement was made necessary by the death of the lamented John J. Williams, which event dissolved the original firm, thus rendering a new arrangement necessary. THE AUDITOR joins with a host of friends in wishing this firm an abundance of prosperity.

Our accomplishments seldom exceed our aspirations. If we would do great things, we must aspire to great things. Ambition may be truly termed the parent of progress and the custodian of the world's future.

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Articles appearing in **THE AUDITOR** are not to be read as having received the endorsement of the society, but are to be taken as individual expressions of opinion, and as such may be answered in future issues. The Editor invites contributions from all Accountants.

Within the profession there is considerable interest manifested in the outcome of the negotiations pending for the amalgamation of the two national organizations into one. It is believed that a national organization representing all the accountants of the whole country can be made a powerful instrument for professional advancement, and the consummation of the plans heretofore outlined for the union of the two organizations referred to will be received with great satisfaction. As soon as this is accomplished provision should be made for the engagement of a capable secretary who could give his whole time to the work of his office, and a suitable salary be provided for him. Both of the present national organizations have been signally fortunate in the character of men chosen to official positions, but it is too much to ask of a secretary that he serve without compensation, since he can under such circumstances only discharge the duties of the position by sacrificing his personal interests. To accomplish most for the profession the secretary should give his sole attention to forwarding the interests of the organization he is serving, and this is only possible where an adequate salary is pro-

vided. An energetic secretary can benefit the profession at large most substantially. There are many fields of activity which may be opened up to the accountant by the well-directed effort of an active, wide-awake secretary, such as have served heretofore and are serving now, but such effort, to be effective, must not be handicapped by the necessity of giving only such time as can be spared from the fight with the wolf.

The article by Dr. Kinley in this issue of **THE AUDITOR** will be of much interest

to accountants, expressing, as **Dr. Kinley's Contribution.** it does, the opinion of an able educator of the mental

training needed as a preparation for entering the profession. There are few who will not admit that the profession has been too much in the hands of men who entered it more by accident than design, and that its recognition has been retarded by this fact. As accountancy becomes more fully recognized as a profession, its standard must be raised and only those admitted to it who are equipped to maintain that standard, however high it may be placed. The young man who is considering accountancy as his life work should read Dr. Kinley's article more than once, and determine to follow the suggestions therein contained. The time needed in college will be paid for many times over by the superior mental equipment secured.

A correspondent asks us to define "Good Will" and give a rule for the determination of its value. It is

The Value of Good Will not difficult to define Good Will, but it would be foolish to attempt to prescribe a hard and fast rule for the determination of its value. Good Will represents the earning capacity of a business over and above a fair return on the capital invested. The question of what is a fair return on the capital in-

vested is one that must be determined by the circumstances surrounding each individual case. Manifestly what would be considered a fair return on the capital invested in a sugar refinery could not be so regarded in the case of an automobile factory, for the reason that the output of the one is a staple product, the market for which is practically unlimited, and the necessary machinery for which is developed almost to perfection, while in the case of the other the output is a luxury with a limited market, susceptible of being greatly reduced in value, if not, indeed, made wholly worthless by inventions of superior merit, while the machinery necessary for the production of the output is likewise in danger of becoming obsolete through improvement. It is very evident, therefore, that a fair return on capital invested in manufacturing automobiles would represent a much higher percentage of gain than would be the case with capital employed in refining sugar. In the one case capital would require an extra return for the greater hazard to which it is exposed. This element of hazard to invested capital is one that must be reckoned with and considered in arriving at what constitutes a "fair return."

After settling this question the determination of the value of Good Will as an asset will still require very careful consideration. The first thing to consider is how permanent may be the earning capacity of the business without renewed effort to advance or even sustain it. If the earning capacity of a business is due to the unusual skill or ability of its manager, the chance of the loss of his services must be taken into account. If the earning capacity of a business is attributable to the superiority of its product as compared with that of competitors, the question presents itself, How long may the enjoyment of this advantage be reasonably anticipated? May not the improvement of methods in

the competing plant wipe out this advantage in a day? There are many lines of business where the element of Good Will is not to be considered as of value under any circumstances. Particularly is this true in cases where staples are produced and where the test of their quality is made by well-known standards. There are also lines of business in which Good Will represents practically their sole value. Take the instance of a live stock commission business, in which for ten years the earnings averaged annually \$55,000 and the total investment did not amount to \$2,000. To the owners of this business the Good Will was worth a half million dollars, but their successors might have found it worth very little, because of the element of personality, which is such an important factor in this line. From these observations our correspondent will understand that his inquiries cannot receive a definite reply, susceptible of general application.

We hear the hope frequently expressed that the officials of the Federation will not lose sight of the necessity for legislation in the several states, the effect of which will be to give information gained by an accountant of his client's affairs the character of a privileged communication. As the services of public accountants are more freely used, the necessity of this legislation becomes more and more apparent. The idea that a business man cannot retain accountants to investigate his private affairs and put them in order without taking the chance that some competitor, or personal enemy, will trump up litigation and subpoena the accountants and compel them to disclose their findings is repugnant to every man's sense of justice and fairness. That so far no disastrous results have been experienced from this condition of affairs proves that accountants have been exceedingly loyal and discreet, but matters of such impor-

**Privileged
Communications.**

tance should not be permitted to rest solely on professional loyalty and discretion. Both the public and the accountant should be protected by law, as is done in the case of attorneys who receive information of their client's affairs in a professional capacity. A measure of the kind proposed would surely result in benefit to the profession and it should be pushed.

In another column is published the statistics of embezzlements in the United States during 1904, as compiled by a prominent surety company. We present these figures for the consideration of the business public, to the end that the prevalence of this class of crime may be properly appreciated. It should be borne in mind, however, that these embezzlements represent only those which have come to light, and do not include those instances which for some reason or other were not given publicity. It is probably true that one-half of the discovered embezzlements are never made public, so that \$15,000,000 would more nearly represent the actual amount embezzled. The figures dealt with necessarily relate to those embezzlements which have resulted in discovery. To accountants, however, by far the most interesting embezzlements are those which have not yet been discovered, of which, in the nature of things, there must be a vast number. It is a queer circumstance that many business houses do not have their books audited because they have so much confidence in the man or men who have the custody of funds or securities. There are few instances of embezzlement by any other than those holding confidential positions, because those who are not trusted are given no opportunity to embezzle.

The fact that confidence is reposed in an employe becomes, therefore, an argument in favor of having his accounts audited rather than an argument against that

procedure. The great struggle going on in this country for wealth, and the power which wealth confers, does much to induce embezzlement, while the temptations spread before employes to avail themselves of pleasures more expensive than they can afford is probably even a stronger inducement to dishonesty. But whatever the inducement, the stubborn fact remains that trusted employes will steal, and it behooves the careful business man to recognize this fact and take steps to protect his property against the peculations of the employe and at the same time protect the employe from his own weakness or cupidity.

It is well known that embezzlements seldom occur in establishments that are regularly audited by public accountants, and when they do occur they represent only a small amount compared with the sums taken from houses not similarly protected. The employe knows that his day of reckoning will come when the accounts are audited and he generally refrains from stealing, being in wholesome fear of discovery and the consequences thereof. If an employe whose accounts are regularly audited does fall from grace it will be found that he has only taken an amount equal to what he believed he could easily replace. In some cases, of course, it will be found that the employe has bolted with all he could lay hands on, but even this is a better condition than the long-drawn-out period of peculation, extending frequently over a term of many years, which is encountered in those establishments where no auditor has ever been engaged. The surety companies are probably the best authorities on the cause and prevention of embezzlements, and as every fidelity bond issued by them contains a provision that the accounts of the bonded employe are to be periodically audited, it needs no further remark to make plain what the surety companies think of auditing as a preventative of embezzlements.

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SOME SPECIAL POINTS IN ACCOUNTANCY PRACTICE

BEING A LECTURE GIVEN ON MARCH 8 BEFORE THE SCHOOL OF COMMERCE, ACCOUNTS AND FINANCE, NEW YORK UNIVERSITY

BY ARTHUR LOWES DICKINSON, M. A., F. C. A., C. P. A.

PRELIMINARY.

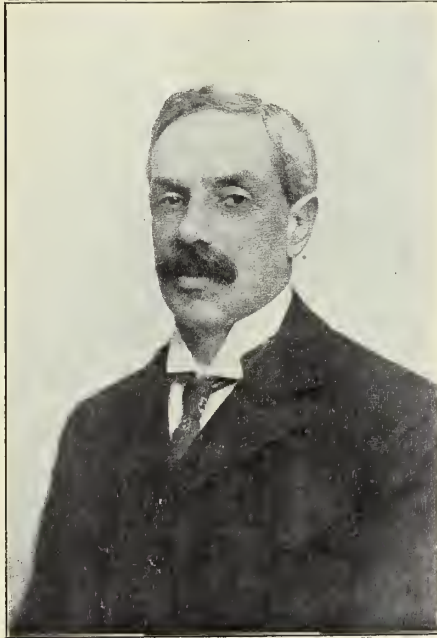
Among the objects for which the School of Commerce, Accounts and Finance was established, not the least important is the training of its students in the principles of commercial science, and in the subjects required for the examination for the degree of Certified Public Accountant, preparatory to practical work as professional accountants. The value of such a training for future members of that profession can hardly be overestimated as a means of raising its standard to the level already attained in England and Scotland, where the profession ranks in importance with those of law and medicine.

ACCOUNTANCY AS A PROFESSION.

In this country it is still struggling for recognition, and the general public are only beginning to realize its value to the investing and business community. The idea is still largely prevalent that a public account-

ant is merely an expert bookkeeper, and that his duties consist mainly of writing up and balancing books of account, and checking the arithmetical accuracy of the figures

in statements of earnings or balance sheets, and yet such duties, and the qualifications necessary therefor, form only a small fraction of those required of the successful practicing public accountant. His services are mainly of value in relation to problems involving a thorough knowledge of the principles of commerce, finance and law, and in the application of these principles to any given series of facts disclosed by the examination, not merely of



the books of account, but of the original transactions which these books should record. In other words, the public accountant is a skilled investigator, who is continually applying his wide training and experience to the ascertainment of facts from any material to which he can

obtain access, while the bookkeeper, or expert bookkeeper, merely ascertains such facts as may be recorded in his books or records in his books such facts as have been ascertained for him by others.

Accounting problems may, therefore, be divided into two groups:

1. Bookkeeping, being either those which deal with the correct method of recording any given set of facts, or those which involve a correct interpretation of the facts, which have been so recorded, and

2. The more difficult and important ones of ascertaining upon a proper interpretation of legal and other documents, and upon sound commercial or financial principles, the actual facts which have to be or should have been recorded in the books.

BOOKKEEPING PROBLEMS.

The first class of problems resolves itself into a thorough appreciation of the elementary principles forming the basis of double entry bookkeeping, and while you are all probably familiar with these principles, they are at the same time so important to a quick solution of purely bookkeeping difficulties, that it may be well to repeat shortly here the following fundamental rules:

1. "A" is a debtor to "B" for whatever in commodities, facilities or services he receives from "B."

2. "A" is a creditor of "B" for whatever in commodities, facilities or services he delivers to "B."

3. Every transaction involves a receipt by "A" and a delivery by "B," or vice versa.

By convention also:

4. The consumption or destruction of anything of value is treated as a delivery of that thing to an inanimate or nominal account describing the operation, and

5. The production or origin of something of value is treated as a receipt of that thing from an inanimate or nominal ac-

count, describing the process which has originated it.

The thorough understanding of these principles and their application to every transaction, remembering always that the transfer of anything of value from one person to another, or from one operation to another, constitutes a transaction, will solve the most complicated bookkeeping question that can be devised. Your attention is called to these somewhat elementary matters in order that you may judge from a consideration of the more important accounting problems with which this lecture more particularly deals, to what an extent accountancy science differs from bookkeeping science, and may thus appreciate that while an accountant must be a good bookkeeper, a bookkeeper may easily be incapable of becoming an accountant.

ORGANIZATION ACCOUNTANCY.

Turning then to the main purpose of this lecture, it will be useful first to consider some of the important questions involved in opening the books of a new corporation. The basis in this case is the articles of incorporation and by-laws of the corporation. These documents must be carefully studied, and all provision therein, in any way relating to the property to be acquired or the financial conduct of the business, must be carefully noted. There will in many cases be agreements or contracts for the purchase of some business concern, manufacturing or otherwise, and out of the provisions of such contracts difficult accounting questions may arise. These questions are the same in the case of a firm as in the case of a corporation, and the same principles are involved, but inasmuch as a firm, with the consent of the individual partners, is not as between those partners bound by any principles, either of law or accountancy, as is a corporation, it will be convenient to assume throughout that the latter is under consideration.

The assumed facts are as follows: A corporation is formed on January 1, 1901, with an authorized capital of \$1,000,000, for the purpose, among other things, of purchasing a manufacturing business as a going concern. The contract between the corporation and its promoters, dated January 1, 1901, provides that the business to be purchased shall be taken over as from July 1, 1900, and that interest on the purchase money of \$900,000 shall be paid to the vendors in lieu of profits, which may have been earned from July 1 up to the date of completion of the purchase. The balance sheet submitted to the purchasers as of July 1, 1900, and accepted by them as the basis of the contract, shows the following figures extracted from the books:

Capital Assets—

Land	\$ 30,000	
Buildings	90,000	
Fixed plant and machinery	180,000	
Loose tools.....	25,000	
	<hr/>	\$325,000

Current Assets—

Inventories of manufactured products, stores and material on hand.	\$125,000
Accounts receivable....	90,000
Cash	10,000
	<hr/>
	\$225,000

Less Current Liabilities—

For accounts payable...	25,000	\$200,000
	<hr/>	<hr/>

Total Assets after deducting liabilities\$525,000

The books also show that the profits for the three years ending July 1, 1900, have averaged \$75,000 per annum, and after the purchase has been completed under the contract, it is ascertained that the profits from July 1, 1900, to January 1, 1901, have, according to the books kept by the vendors, amounted to \$50,000, and that during those six months a sum of \$20,000

was distributed among the partners or stockholders of the vendor concern. The total assets to be acquired amounting to \$525,000, and the purchase money to \$900,000, the difference, namely, \$375,000, might at first sight be taken to represent the value of the good-will of the business purchased, being the equivalent, it will be seen, of five years' purchase of the average profits, and it is quite probable that this was the actual basis of the contract.

It is no exaggeration to say that in the majority of such cases as that here given, the books of the new corporation would have been opened as of July 1, 1900, on the basis of that balance sheet, and profits earned during the next six months, after deduction of the interest, amounting to \$22,500, as provided in the contract, would be treated as its profits. But a little consideration will show that this is not a correct basis of facts for opening the books of the new company. To begin with, the company did not come into existence until January 1, 1901, and as it obviously cannot acquire property before its existence, it is clear that what it has really purchased is not the property as it was at July 1, 1900, but as it was at the date of the contract to purchase, which happens also to be that of the formation of the company, viz., January 1, 1901. Moreover, the contract provides for the purchase of the assets with the addition of profits earned for the preceding six months, and the purchase money was correspondingly larger than it would otherwise have been. The profits so earned, less the sum of \$20,000 distributed, have presumably remained in the business, and the surplus assets will, therefore, have increased by \$30,000 during that period. This increase may be represented either by additional construction expenditure made during that period, or by increased current assets, or by both, and there will probably also be a variation in the current liabilities. The interest due to vendors up to January

1, 1901, exceeds the profits withdrawn by \$2,500, which is, therefore, a liability on that date, so that the new corporation is actually getting in property of one kind or another \$27,500 more than it would have got if the contract had not provided for its acquisition of the profits accrued during this six months. It may be assumed, therefore, that the purchase price of \$900,000 is greater by this amount than it would have been if the accrued profits which are returned to the corporation when it obtains possession of the property had not been acquired, or, in other words, that the price which it actually pays for the good-will is not \$375,000, but \$347,500.

The important point to be noted here is that the interpretation of the contract depends partly

- (a) Upon its date,
- (b) Upon the date of the statement of the position of the business purchased, which formed the basis of the agreed purchase price, and
- (c) Upon the date of formation of the corporation.

A corporation cannot earn profits when it is not in existence; if, therefore, it in any way acquires profits which were earned before the date of its formation it must in some way have purchased them, as the alternative supposition of a free gift hardly needs consideration. Its subsequent receipt of the assets representing these profits can, therefore, only be a return of part of this purchase money. If, however, the company had been incorporated on July 1, 1900, and a contract had been made on the same date and on the basis of the July 1 balance sheet, with a provision that the business should not actually be taken over until January 1, 1901, then, clearly, after July 1, 1900, the business is being carried on for the benefit of the corporation, and the accruing profits, less interest, amounting to \$22,500, are clearly profits of the corporation. But under the conditions as-

sumed to exist, it would seem perfectly clear that the profits in question are merely a return to the corporation of part of its own assets, and not in any sense a profit.

And yet there is considerable contention at the present time over this apparently simple point. Where a corporation has purchased property at an agreed price, and the vendors have further undertaken to provide a certain sum in cash for working capital, lawyers have maintained that this sum so provided is a profit to the corporation and can be used for the payment of dividends. But vendors are men of business, and it is not their practice to give something for nothing. A contract must be assumed to be the result of a bargain between purchaser and seller, and whatever the purchaser is to receive under the contract must be set off exactly against what the vendor is to receive. It is difficult to believe that if such a contract formed the subject of legal proceedings any other view could be taken than that the so-called gift for working capital was merely a return to the purchaser of a portion of his purchase money, and should be so treated in the accounts. If the reverse principle were upheld the sum of \$27,500 in our hypothetical case would be treated as a clear profit to the corporation, distributable in dividends; thereby it would seem returning to the stockholders a portion of the subscribed capital.

Having disposed of this important preliminary point, it is now clear that the figures of assets and liabilities at July 1, 1900, are not a proper basis for opening the books of the new corporation, and that a fresh balance sheet, as at January 1, must be prepared. On being advised to this effect, the officers decided on February 28 to have a revaluation made of all the companies' assets, having reason to doubt the accuracy of the July balance sheet. It may be remarked that the accuracy of this balance sheet had surely been substantiated

on behalf of the corporation before the contract for purchase had been entered into. But you will perhaps be surprised to hear that such contracts are still frequently made for large sums, relying entirely on statements of financial position furnished by the vendors, who, without any intent to deceive, will naturally make the best showing they can, or may even be deceived by errors of principle made by their own subordinates. The insistence on the part of the purchasers of an impartial investigation of all such statements by public accountants before the contract was entered into would certainly save large sums of money to future stockholders.

In our case it is assumed that no investigation was made, and fortunately for the stockholders, the results of the revaluation prove that they have got a better bargain

than they thought, as the following statement as at February 28, 1901, shows:

<i>Capital Assets—</i>			
Land	\$	50,000	
Buildings, etc.....		100,000	
Fixed plant and machinery		200,000	
Loose tools.....		30,000	
			\$380,000
<i>Current Assets—</i>			
Inventories and manufactured products, stores .			
and material on hand.	\$	120,000	
Accounts receivable.....		100,000	
Cash		25,000	
			245,000
<i>Less Current Liabilities—</i>			
For accounts payable...	\$	20,000	\$225,000
(To be Continued).			\$605,000

SYSTEM FAILURES

BY WILLIAM H. ROBERTS, C. P. A.

This is easily a larger subject than how to succeed in system designing, for in no line of professional work are there more ways to go wrong or greater difficulty in knowing them in advance.

In the first place, there is the failure of the system which is never designed—the failure to convince a prospective client either that he needs the work, that he needs it now, that he can afford the cost, or, to “get personal,” that you are the one who can solve his problems and remove his difficulties.

The man who is conducting business along old-fashioned lines is probably one of those men who cheerfully admits that he doesn’t personally “know anything about bookkeeping,” in a tone which indicates his complacency in the opinion that his talents are of a much higher order, but who will tell you in the same breath that he has a

“first-class bookkeeper, the equal of any, who has been in the house twenty years or so.”

This type of employer probably is not capable of seeing the ridiculous contradiction which these two statements involve.

He can form some judgment as to the ability of a mechanic or salesman without being able himself to duplicate their work, but with the bookkeeper it is very different.

Such an employer has to accept quality, quantity and results of the bookkeeper’s work at the bookkeeper’s own valuation and often with serious consequences.

The following actual occurrence will illustrate one of the numerous ways in which this sort of employer may be a party to a failure.

A certain bookkeeper approached a well-known public accountant recently, with a request for assistance in locating his errors,

admitting that his books had been out of balance for several months with a large apparent shortage, which he was positive did not really exist, but which he had exhausted his own skill in trying to locate.

The accountant agreed to do the work if the permission of the employer was obtained, explaining in answer to protests of the bookkeeper that he did not wish his employer to know of the existing conditions, that the books belonged absolutely to the employer and that no one had the right to see them without his consent.

As a compromise it was finally arranged that the accountant should call on the employer and try to induce him to have an audit on general principles, with the result that Mr. Employer refused to consider an audit as anything but a waste of money, as he had a "first-class bookkeeper, absolutely trustworthy, and who never failed to get a balance promptly every month."

The bookkeeper probably continued his search for an accountant with less scrupulous ideas of professional ethics.

This bookkeeper, like many others, was floundering in a mire of complications, the result of rapid expansion of business and an antiquated office system, and neither he nor his employer really appreciated the fact, nor are they likely to do so until something happens to bring into the case an up-to-date public accountant.

There is no more deep-rooted idea in the mind of the old-style business man than that "no outsider can come in here and teach me anything about my business," and in spite of the fact that he long ago conceded the necessity for an architect, the mechanical and electrical expert, the advertising manager and other specialists, he cannot or will not see that the necessity for special treatment is even greater in the office, which is to the business what the brain is to the body.

The system expert who interviews such a possible client has need to exercise all

his tact and diplomatic ability to avoid a premature failure.

Next we have the man who admits that improvements are needed and who tries to work out something himself, partly because he thinks he is the most capable person to do it, and partly to save expense. He gets an idea from some friend in another line of business, some trade paper or "mail order" book, and proceeds to experiment, spending much time—his own and his employes—and producing endless confusion while various ways are tried to cut over the second-hand scheme to fit, with about the same result as if he had bought his clothes in the same way—very uncomfortable, far from economical in the long run and wholly disappointing.

Then there is the man who has a good general knowledge of bookkeeping and who, like the other, thinks that no help can be expected from a "rank outsider," and so tackles the problem himself. Fair results may sometimes be reached in this way, if he has nothing else to do but study the case uninterruptedly, but of how many business men is this true in these swift and strenuous times?

The constant interruptions, to say nothing of the fact that his time is worth too much in other ways, should be sufficient argument against this idea, since success will come, if at all, only after expensive trials, and it may well be doubted if any case exists of system making by an "insider" where the services of a capable specialist would not have saved money and brain fag as well.

Then, of course, we have always with us the man who would like to see things improved if it didn't cost anything, but then he doesn't count—he is the same fellow who does not have audits for the same reason, or if he does, lets the work to the lowest bidder.

Still another sort of man who has been hard to interest in the past is the fortunate

proprietor or manager of a business in which there is a large margin of profit, since he is not in danger of crossing that invisible line between a surplus and a deficit. The actual saving resulting from application of a thorough system in such a business is sometimes astonishing, one manufacturer reporting \$20,000 saved in six months and another claiming that one blank alone saved in a short time the entire cost of the system, including printing and furniture.

One of the strangest things in this connection is the fact that a man will imitate

his competitor in every improvement he possibly can except in his cost or accounting system.

It is a common remark of manufacturers who have emerged from darkness by means of a scientific office organization, that it would be a grand thing for all concerned if their competitors only knew as much about costs as they might and should, and it is a well established fact that ignorance of this *first essential* to success has made the history of American manufacturing one long story of cut-throat competition and then—combination.

THE DUTIES OF PROFESSIONAL ACCOUNTANTS IN CONNECTION WITH INVESTED CAPITAL BOTH PRIOR TO AND SUBSEQUENT TO THE INVESTMENT

BY FRANCIS W. PIXLEY, F. C. A., BARRISTER-AT-LAW.

(Concluded from the February issue.)

It will not be surprising, however, to those who are aware of the very slow progress innovations of any kind make on the other side of the Atlantic to learn that although it is now exactly sixty years ago since auditors of companies were recognized, and were, in fact, for a short time, compulsorily enforced on companies by legislation, yet at no time have any qualifications for holding the office ever been required, except, perhaps, the doubtful, if not actually improper, one of their being shareholders. In those cases where this absurd requirement was imposed, it necessarily followed that in order to obtain an auditor the list of shareholders had to be scrutinized until the name of one known personally to the directors, or perhaps the secretary or the manager, was discovered. The person thus selected was asked to undertake the duties without any effort whatever being made to ascertain if he was possessed of a single qualification for his office, and many of you will perhaps be surprised to learn that at

the present moment no opposition would be raised, or, in fact, could legally be raised, by the Board of Trade, or any other English government department, were the accounts of our largest enterprises to be intrusted to the audit of a person unacquainted with the most elementary knowledge of bookkeeping and accounts. In making this statement I do not put forward a doctrine that a perfect knowledge of account keeping necessarily qualifies the possessor to efficiently perform the duties of auditors, for while it is absolutely necessary that an auditor should be possessed of a complete knowledge of bookkeeping, both generally and as applied to the varieties of businesses whose accounts he has to audit, it does not follow that a man capable of keeping a set of books, or superintending the bookkeeping staff of the largest commercial concern, possesses the qualifications necessary for an auditor.

In the same way that a great painter, sculptor, or writer, need not be a good critic,

in the same way an experienced bookkeeper might utterly fail in the performance of an audit of a much less important concern than the one whose affairs he is intrusted with the duty of recording. An auditor is a critic, but, different to the painter, sculptor or writer, it is absolutely necessary he be capable of performing himself the work of those he has to criticise, and of taking out and agreeing a trial balance, and preparing therefrom the profit and loss account and balance sheet. He must at the same time be equally capable of reversing the operation and of dissecting and analyzing accounts placed before him for his approval and certificate.

Legislation in England having utterly failed to deal with the audit of accounts of public companies, the common sense of the business community has fortunately rectified the deficiency. About the time of the heavy commercial depression caused in 1866 through the failure of some of the largest financial institutions in London, followed by many in the provinces, causing widespread misery among investors, there commenced the practice of replacing the shareholder auditor by the professional accountant. The weeding out of the amateur auditor proceeded slowly, but by the time the Institute of Chartered Accountants in England and Wales was incorporated by royal charter, a large proportion of the joint stock banks, discount houses and other financial institutions had professional accountants for their auditors. This praiseworthy practice gradually spread to the private banks, several of which have in London existed for over 200 years. About a dozen years ago three of the oldest of these private banks, after consultation as to the advisability of so doing, set the example, which was followed by many others, of placing their books voluntarily in the hands of chartered accountants, so that they might present an audited statement of assets and liabilities to their customers. Notwithstanding this, there are, I

regret to state, at the present moment a few joint stock banks, insurance companies and other corporations which still continue to elect year after year shareholders as auditors without having any regard to their qualifications.

The duties of an auditor vary in Great Britain, as doubtless they do here, according as to whether his client is a private one, free to give his own instructions, or whether the audit is performed for a body of shareholders in a joint stock company, and consequently under statutory powers, which throw the onus entirely on the auditor of deciding as to what details to be performed in the course of the audit are or are not necessary.

When an auditor receives his instructions from what I have called a private client, he should, if he be of opinion that they are inadequate, so inform his client, and thus give him an opportunity of amending them, as to perform the audit strictly according to instructions, knowing that it would be wholly, or even partly, useless to his client, is, I am sure you will agree with me, unworthy of any professional man.

It has always been traditional in every profession practiced in Great Britain that in giving advice to a client on any matter that that advice shall be given entirely in the interests of the client, and without any regard to the consequences such advice may entail on the professional adviser. When, therefore, a professional accountant receives instructions to perform an audit in such a manner as he feels will be insufficient for the purpose, and he fears that his suggestions, either on the ground of additional expense or for another reason, may lose him his client, this should not weigh with him for a moment.

Again, when having undertaken an audit for a fixed fee the auditor finds, after having made some progress with the audit, that the time it will occupy will exceed that which he anticipated when the fee was

fixed, it would not merely be unprofessional, but dishonest, to omit any portion of the original scheme of audit if necessary to perform it in an efficient manner. He may, of course, make representations to his client as soon as he becomes aware of the inadequacy of the fee he is to receive, or wait until the audit is concluded; but should he adopt the former plan and the reply is unfavorable, his duty to his client is clear, and the audit has to be done as thoroughly as if full profit charges were to be received.

In auditing the accounts of a joint stock concern the auditor is unfettered by instructions as to how he is to perform his duties. The responsibilities, however, are much heavier than when acting for a private client, as the shareholders look to him to not merely certify to the correctness of the profits out of which their dividends are declared, but also the correctness of the balance sheet, which shows the financial position of their invested capital in the concern, so far as the figures representing the assets in the books of account are concerned. Before, however, I refer to the balance sheet, I must make some remarks on the principles of an audit, without, however, I trust, having even the appearance of attempting to teach you the ordinary duties of an auditor, with which you are as fully acquainted as I am.

The observations I have already made as to the manner in which an accountant investigating the accounts of a concern previously to the investment of capital may be deceived apply equally to the audit of the profit and loss account of a concern in which his clients' capital has already embarked. An auditor has, therefore, always to be on his guard, but, at the same time, he is not placed in the unpleasant situation of having to look upon everyone he comes across with suspicion. I am not acquainted with the law bearing upon the accounts of American companies and their audit, but I believe there is little if any difference between the

American and English law in this respect, and that your judges would take the same view as have ours.

In a case which came before the English courts some years ago the counsel on one side, in the course of their arguments, endeavored to throw upon auditors duties of such a nature which, if they had been sustained, would have rendered the office a most perilous one to have subsequently undertaken. Fortunately, however, the Court of Appeal took what may be called a practical and common sense view, as well as one which, no doubt, was strictly correct according to law. In the course of the judgment it was stated by one of the judges:

"An auditor, however, is not bound to do more than exercise reasonable care and skill in making inquiries and investigations. He is not an insurer; he does not guarantee that the books do correctly show the true position of the company's affairs; he does not even guarantee that his balance sheet is accurate according to the books of the company. If he did, he would be responsible for error on his part, even if he were himself deceived without any want of reasonable care on his part, say, by the fraudulent concealment of a book from him. His obligation is not so onerous as this. Such I take to be the duty of the auditor: He must be honest, i. e., he must not certify what he does not believe to be true, and he must take reasonable care and skill before he believes that what he certifies is true. What is reasonable care in any particular case must depend upon the circumstances of that case. Where there is nothing to excite suspicion very little inquiry will be reasonably sufficient, and in practice, I believe, business men select a few cases at haphazard, see that they are right, and assume that others like them are correct also. Where suspicion is aroused more care is obviously necessary, but, still, an auditor is not bound to exercise more than reasonable care and skill, even in a case of suspicion."

Again, in another case one of the judges of our Court of Appeal said: "Auditors must not be made liable for not tracking out ingenious and carefully laid schemes of fraud when there is nothing to arouse their suspicion, and when these frauds are perpetrated by tried servants of the company, and are undetected for years by the directors. So to hold would make the position of an auditor untenable."

At the same time it has also been held by a judge, now a member of our Court of Appeal, that "it is the duty of an auditor of a company's accounts not to confine himself to verifying the arithmetical accuracy of the balance sheet, but to inquire into its substantial accuracy, and to ascertain that it contains the particulars specified in the articles of association, and is properly drawn up so as to contain a true and correct report of the state of the company's affairs."

Again, another judge of the Court of Appeal said: "The auditor's business is to ascertain and state the true financial position of the company at the time of the audit, and his duty is confined to that. But then comes the question: How is he to ascertain that position? The answer is: By examining the books of the company. But he does not discharge his duty by doing this without inquiry, and without taking any trouble to see that the books themselves show the company's true position. He must take reasonable care to ascertain that they do so. Unless he does this, his audit would be worse than an idle farce."

Now, although these opinions were given in delivering judgments after legal arguments had been heard on both sides, I do not think that any practical man can disagree with or even cavil at any of the doctrines here laid down. If professional accountants do not admit that their duties carry with them great and important responsibilities, the profession will never take the position in the eyes of the financial and commercial world we who have taken the trouble to at-

tend this conference evidently aspire to its holding.

It has long been recognized by professional accountants that it is impossible in the case of company audits for the auditor to personally perform all the details of the audit, such as the calling over from one book to another, the examination of vouchers, and, in fact, the ordinary checking work. This has also been understood by the financial and commercial world, and has lately been recognized by the English judges. The doctrine has frequently been propounded that it is better to employ a young accountant who can do the whole of the detail himself, and devote all his personal time to an audit, and in our profession, like in every other profession, there is work which can be done as well by a young practitioner as by one of more experience. But in the audit of the accounts of large companies many points arise which require considerable experience at times to deal with, and in the same way that as persons in heavy legal cases employ lawyers of eminence, so those who employ professional accountants in large practice obtain the benefit of their experience, while the managing clerks in their chambers are as fully experienced as those newly admitted practicing on their own account. You, of course, understand I am saying nothing to the disadvantage of those just commencing their career, but am only making these remarks in consequence of the mistaken idea that exists in certain minds that the profession of accountancy can be learned in a short time, quite forgetting that when the English and Scottish institutes received their charters it was considered necessary to enforce a long period of apprenticeship previous to the reception of the certificate of practice.

For practical purposes an audit may be divided into three parts, namely, to guard against (1) errors of omission, (2) errors of commission and (3) errors of principle. With regard to errors of omission, I have

already, when speaking of investigations, referred to those of a nature which it is almost impossible to guard against, but with reference to the ordinary work of an audit, it is most desirable that entries in the cash book, as well as in other books of account, should be checked as far as possible from documents obtained from independent sources, in order that the auditor may be satisfied that the company is properly charged with all cash received and liabilities incurred. In other words, it is not sufficient for an auditor to take for granted that the income of a company has been brought into account, and that his only duty is to satisfy himself that it has been expended in the manner indicated in the accounts and according to law.

Errors of commission may be either accidental or intentional. As regards the former, these are usually discovered by the mere mechanical process of checking the items of one book with corresponding items in another until carried into the ledger. As regards intentional errors of commission, experience alone can detect them. Nothing but practice can enable an auditor to deal effectually with those who are intentionally trying to deceive him.

Errors of principle are frequently found in statements of account placed before an auditor for certification without there necessarily being any attempt whatever to deceive him, although, of course, many such attempts are at times made, in order to make the profits appear better than they really are. Expenditure which ought to be charged against the revenue for the year is frequently carried to capital account, an attempt being made to justify its inclusion there on the ground that, although it may not be represented by an asset, the concern will have the benefit of it for many years to come. Questions also connected with depreciation come under this heading, as does also whether or no investments have been made in legally authorized securities.

In the audit of the first accounts of a newly registered company, it is very important that all the transactions connected with the issue of the share capital should be thoroughly examined, and it is the duty of the auditor to ascertain that both the share and loan capital have not been issued in excess of the amount authorized under the legal constitution of the company. It has long been our practice on the other side of the water not to accept bank pass books as a proof of the correctness of balances at bankers, but to obtain from bankers special certificates as to balances standing to the credit of their customers at the close of business on the days to which the accounts are made up. Cases have been known of false pass books having been prepared for production to auditors. It is also our practice, in vouching payments of every description, to have produced to us the original receipts, or else to state the reason why any have not been shown to us, so that our clients may determine as to whether or no further evidence shall be called for.

In dealing with the duties of the professional accountant previous to the investment of capital, I pointed out that it is not usual for him to give a certificate beyond that of the profits for the period selected by the promoter, or perhaps the directors, of the proposed company. In the case of an audit a balance sheet has also to be certified. Now a balance sheet is a document very much misunderstood by the general public. Their difficulty is one with which I have much sympathy, but, at the same time, I do not see any way of suggesting a remedy, except that it should never be referred to as a statement of liabilities and assets. In the case of banks and a few other concerns this title is correct, but in the majority of companies a balance sheet is nothing more than as indicated by its title, namely, a sheet or collection of balances, and is, as we all know, a statement in an abstract form of the debit and credit balances of the ledgers,

after the elimination of such balances as have been transferred to the revenue or profit and loss account.

As regards the debit side of a balance sheet, or the liability side, as it is frequently called, the only items which appear to puzzle shareholders is that it includes their capital, amounts placed to reserve, and unappropriated profits; but, as regards the credit side, which is so frequently called the asset side, it is exceedingly difficult to make shareholders understand that the values placed against the items are merely those of the books, and that it does not necessarily mean that their commercial values in any way approach the figures set out. It is, however, the recognized duty of the auditor in dealing with certain assets—such as investments, debtors and cash in hand—to satisfy himself that the values placed upon them are really their commercial value; but when we come to good-will, land, buildings, patents, and even stock in trade, it very seldom happens that the figures are such as would be obtained were the property submitted for sale. This is always so difficult to explain to a meeting of shareholders when questions are asked, and more particularly to a meeting of shareholders of a company that has gone into liquidation, when they learn, as they frequently have to do, that the assets are not expected to yield a quarter, or even a tenth part, of the amounts taken credit for in the last audited balance sheet of the company.

As regards good-will, there is great divergence of view as to how it ought to be treated in the accounts, especially in those cases where there had been a great falling off in the business of a company. Some accountants are strongly of opinion that in these cases good-will should be gradually written down until it reaches a figure more commensurate with the company's reduced circumstances. This would in many cases cause an entire suspension of the payment of dividends, and is entirely opposite to the views of most professional accountants. As,

however, the present law of England does not require this diminution of good-will to take place, these more drastic views are not likely to prevail. In a case which came before the English law courts in 1895 it was decided that the good-will of a trading company is fixed capital, and in ascertaining profits it was not necessary to make good any depreciation in respect of it.

There are also conflicting views as to the way in which mortgaged property should be dealt with in balance sheets. I am strongly of opinion that in every instance a mortgaged property should not be included in the credit side of the balance sheet at its full value, and the amount due to the mortgagees included among the liabilities, but that the credit side of the balance sheet should only contain the balance between these two amounts. I admit that there is a difficulty in dealing with mortgaged property in this manner when debentures constituting a floating charge on all the assets of the company have been issued; but where property is specifically mortgaged I am strongly of opinion that the course recommended by me should be followed.

There has of late years been a great increase in Great Britain in the registration of mining companies, and there has doubtless been a similar increase in the United States. In connection with the accounts of such companies there is frequently considerable difficulty in deciding upon the correct amount to charge against the profit and loss account in respect of expenditure on development of the mine, and consequently the amount to place to capital account. Capital is frequently expended which can only be of use for a few years, and which, therefore, ought to be charged entirely against the revenue of that period, so that the expenditure gradually disappears from the periodical balance sheets, while all other capital expenditure should be so treated as to allow of its entire extinction at the expiration of the lease under which the mine is worked.

It would be well if the accounts of mining companies were compulsorily prepared on some scientific basis of this sort, the engineers in charge being responsible for the apportionment.

Auditors, moreover, ought to be allowed to consult, at the expense of the company, engineers and valuers in connection with certain items in balance sheets, such as "Works in progress" or "Stock in trade," as it is impossible for an auditor to have a practical knowledge of the value of assets of this nature.

Many persons consider that the duties of auditors of companies are toward the shareholders for the time being, who have a right to the full profits earned during the actual time they are holders of their shares. If, of course, the statutes of a company provide that each year the profits of the year shall be divided among the shareholders, then perhaps this view is correct; but this is very rarely the case, the distribution of profits of companies being in Great Britain left to the discretion of the directors. I hold the view that the duties of auditors of a company are to that company as an institution, and not to its individual shareholders; consequently, I am of opinion that what is known as "secret reserves" are right and proper, and tend toward the maintenance of the company as a permanent institution, and that, in fact, without these secret reserves it is quite impossible, having regard to the fluctuations of both financial and trading operations, for any company to exist beyond a very limited period. At the same time, these reserves must be honestly made and in the interests of the company. For directors to create secret reserves with the object of withholding profits legitimately earned from distribution to the shareholders, so as to induce them to dispose of their holdings and acquire such holdings for themselves, is as flagrant an act of dishonesty as can be conceived; and should auditors have any reason to believe that reserves are being created

through improper motives they should protest against this, and, if necessary, so report to their shareholders. When, however, reserves are made bona fide in the interests of the company, then—although the auditors may consider them beyond what may be actually required—they are, in my opinion, justified in passing them without comment, knowing that in so doing the financial position of the company will be strengthened.

I will not, however, go further into details connected with an auditor's duties. My only object in referring to those points I have mentioned is that it may perhaps lead later on to discussion, and consequently to some practical results.

And when an auditor's duty has been completed, what is it that has really been aimed at? He has by means of his own labor, and that of his clerks, done a certain amount of mechanical checking, and looked into and settled certain questions of principle; he has satisfied himself that he has acted according to the general law of the country, read in combination with the special law relating to each audit, such as a deed of partnership or the statutes of a company. In other words, he is satisfied he has obeyed the law, and consequently has nothing to fear should his client hereafter suffer some loss for which he might endeavor to make his professional adviser responsible. But is this enough? I think you will agree with me that to perform his duty legally, so that he cannot be assailed, is not the sole aim of an auditor, but that he has a much higher one.

He must have so conducted his audit as to be satisfied in his own mind that the accounts he has certified are not merely correct according to law, but that those who read his signature can thoroughly rely on the accuracy of the statements above it. He must also feel that there is not concealed under any heading a single fact which ought to be known to his clients, and which, if known, would cause them to take

a different view of the position, and, if shareholders in a company, might induce them at the general meeting at which the accounts will be submitted for their approval to refuse to pass them.

An auditor who has not the courage or honesty to stand up against those who submit accounts for his examination which are not entirely honest cannot shield himself by means of a remark in his certificate which if noticed by an intelligent shareholder might put him and others on inquiry. To quote again from a judgment of one of our English judges, "A person whose duty it is to convey information to others does not discharge that duty by simply giving them so much information as is calculated to induce them, or some of them, to ask for more. Information, and means of information, are by no means equivalent terms. . . . An auditor who gives shareholders means of information, instead of information, respecting a company's financial position does so at his peril, and runs the very serious risk of being held judicially to have failed to discharge his duty."

Honest and straightforward dealing has always been a characteristic of the Saxon

race. Since professional accountancy has been established in Great Britain and Ireland there has been inculcated upon students, both in lectures and every department of their studies, the necessity of being straightforward in their dealings with their clients, and I feel sure that you on this side of the Atlantic are taking and will continue to take the same line.

I fervently trust that one of the results of this great conference in which, thanks to your hospitality and to the kindness of my own institute, I have been enabled to take a part will be the elevation of the profession in the eyes of the world, and that the professional accountants of the United Kingdom and the United States will work together, not only for mutual advantage, but for the benefit of those who on both sides of the Atlantic may rely on their professional assistance. In the words of one of your great poets, John Greenleaf Whittier:

"'Thicker than water,' in one rill

Through centuries of story

Our Saxon blood has flowed, and still

We share with you its good and ill,

The shadow and the glory."

THE ANNUAL AUDIT

CONTRIBUTED.

A great deal of ink and paper have been devoted to urging the importance of periodical audits and the effort cannot be said to have been in vain, since they are vastly better than none.

The business world is coming to accept such examinations as a necessity along with telephones, adding machines and other good things, but like everything else the audit idea may be improved upon.

The periodical plan is open to some serious objections not often sufficiently considered by the business man.

First, eight out of ten concerns are audited once each year on the theory that a detailed showing of annual results is about the most important thing which an audit will produce, and the end of the fiscal year is naturally chosen as the proper date for the work, and as in at least three-fourths of these cases the fiscal and calendar years correspond, a congestion of this class of work occurs each January.

The business man probably does not reflect much on the result of this arrangement, but thinks he is neglected by the pub-

lic accountant of his selection if he does not begin work promptly, "as soon as the books are closed, which will probably be about January 10."

He doubtless feels that the troubles of the accountant are none of his, having already a few extra at that season, but is he entirely right?

Aside from the general interest which any man should take in the welfare of those with whom he holds so close a relationship as that between the accountant and his clients, the business man may find, if he looks for it, a stronger if more selfish reason for considering the accountant's side of this question. The attempt to crowd into one or two months, say one-half, or one-third even, of the audits he is called upon to conduct during the year results in troubles for all concerned.

The work may be hurriedly and improperly done, or if the accountant is too conscientious to permit that, it may be delayed until the client's patience is exhausted. Of course the accountant of standing has much other business besides periodical audits, but the position of an accounting firm, corporation or individual with more work than can possibly be done in January and February (and that is the chronic condition of all that are worth considering), but with the knowledge that the volume will shrink considerably for the balance of the year, is not entirely satisfactory.

More help must be taken on, but it stands to reason that a permanent force sufficient for the busiest period would be impossible, and so recourse must be had to extra men who are rarely as valuable, if as able, as those trained under personal direction of the managing accountant.

There is a saying among us that the accountant or helper must be very bad indeed who is not busy during January, and in this fact there is much to reflect upon.

The troubles and limitations of the ac-

counting business and their unfavorable influence on the service rendered do not, however, furnish the only, nor perhaps the most important argument against the annual audit, since the difficulties already referred to might be corrected by a change of fiscal period by enough business houses, on recognition of the fact that better and perhaps cheaper service might be secured thereby.

An audit should be, first of all, a measure of protection from loss by error or design on the part of employes, and no employer has the moral right to place unnecessary temptation in the way of a cashier or bookkeeper by saying to him in effect, "You have a year in which to do as you please with our money. See that your accounts are all right for the annual round-up."

Experience galore has shown that the knowledge that the check-up is eleven months away has often proved more of a temptation than the opposite, and the present social conditions and tendencies make this increasingly true.

The only kind of an audit that really reaches the case and is of maximum value is one which is made absolutely without notice *on the initiative* of the auditor.

An arrangement for two or more visits of this kind each year will be of vastly more value as fidelity insurance than the extra labor and trouble will cost, and the annual figures can be made up at any time and certified to promptly and to the satisfaction of all concerned.

The bookkeeper and cashier should not expect a chance to *get ready* for an audit, as so many now do, but should *always be ready* at a moment's notice to surrender their trust for examination, and when that condition generally obtains not only will a vast amount of money be saved to its owners, but the number of wrecked homes and ruined lives will be greatly diminished.

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Articles appearing in THE AUDITOR are not to be read as having received the endorsement of the society, but are to be taken as individual expressions of opinion, and as such may be answered in future issues. The Editor invites contributions from all Accountants.

In the last issue of THE AUDITOR we commented upon the fact that there are numerous fields of work for the Accountant which remain practically unexplored and in the opening of which the Federation could be of great assistance. One of the fields which we had in mind was that of Municipal Accounting. There has been done some notable work in Municipal Accounting, but it is possible to count upon the fingers the instances in which municipalities have had this work done. In those cases where the accounts of municipalities have been overhauled it has uniformly been found that such overhauling should have taken place many years ago. It has also been found that the methods of municipal accounting have been primitive, if not indeed obsolete, and wholly insufficient for the purpose of giving a clear and comprehensive idea of the condition of the business affairs of the municipality. We can think of no greater service the national organization can perform for the accounting fraternity than to inaugurate some concerted action in the direction of better municipal accounting, and while some of the benefits to be derived from such action would fall to the good fortune of the Accountants, the largest benefit to be derived from such action would be enjoyed by the municipalities themselves.

The
Municipal
Field.

What has been said with regard to Municipal Accounting applies with equal force to the accounts of other political divisions, such as townships, counties and states. States and Counties, Too.

Any number of cases might be cited wherein the accounts of political divisions above referred to have needed regular auditing, in fact so well recognized is this need that no argument is necessary to establish it. In some countries a necessity of this character might bring action on the part of the citizenship; in the United States, however, everybody is too busy with private affairs to devote much time to the needs of the public. Any movement, therefore, looking toward the institution of business methods in public affairs must of necessity come from a source charged with a selfish interest. The old saying that "what is everybody's business is nobody's business," has no better exemplification than is to be found in the management of public affairs in the United States. Our national organization has done a great work in bringing Accountants to understand that their interests are identical, and that whatever benefits one benefits all, but the field of usefulness of the national organization is by no means ended in bringing about the results above noted, but may be very considerably extended by proper steps being taken to open the eyes of the public to the advantages which will accrue through the use of accounting service in connection with the management of public affairs and the disbursement of public funds.

In this connection it is proper to call the attention of the accounting fraternity to the fact that, hardly without exception, Accountants are delinquent in the matter of showing a proper interest in public affairs. There are few accountants who are known outside of their profession, their acquaintance being largely confined to fellow accountants and to the business community

The
Accountant
in Public
Affairs.

which they serve. This condition is one which should be remedied at once. There is no good reason why Accountants should not take a prominent part in public affairs. Few men are better fitted for a proper understanding of the needs of all political divisions, especially as relates to the matter of revenue and expenditure. It is undoubtedly true that city councils, state legislatures and the national congress would be improved by the election to membership therein of public accountants. These bodies are ordinarily filled with men who do not know a debit from a credit and yet are expected to legislate upon fiscal matters with intelligence. It is true that accountants share the repugnance with which participation in political affairs is regarded by business men generally, but for the sake of the profession this attitude should be abandoned, even if the actual needs of public interests are not accorded the consideration they deserve.

A subject receiving considerable thought on the part of Accountants at this time is that of the best way in which to conduct an accounting business, whether by individual practice, a partnership or a corporation. In some respects individual practice is ideal but in many ways the individual practitioner is handicapped and embarrassed, so that the question to him is one always full of interest. If he leaves his office to attend to duties out of town (as, of course, happens in the business of every accountant) his affairs must remain unattended to during his absence and there is no doubt that he suffers serious loss on account thereof.

There have been notable instances of individual practitioners scoring a large success, but they are exceptional. The most pronounced successes have accrued to the partnerships, and it is undoubtedly the opinion of the majority of the accounting fraternity that the ideal way in which to

conduct the business is through the medium of a partnership.

Within recent years corporations have been formed for the purpose of conducting the business of accounting, and the appearance in the field of these organizations has provoked much discussion as to the propriety of corporations engaging in a work that is purely professional; indeed it seems likely that this matter will continue to be a source of discussion and contention as long as the corporations remain in the field.

THE AUDITOR believes that the discussion of this subject should be undertaken by those competent to handle it and invites contributions upon this subject from both opponents of and adherents to, the corporate plan. It is a subject which should be discussed without excitement and without the use of immoderate language. Accountants engaged in individual practice, or as partners, should show proper consideration for the feelings and interests of Accountants representing corporations, who on their part should bear in mind that Accountants not engaged with corporations feel that the professional field should not be invaded by organizations of that character. It is possible that the question may be settled to the satisfaction of all concerned if it is taken up and handled in the proper spirit. We renew our invitation for contributions both for and against corporations as public accountants.

JAMES YALDEN

At a special meeting of the board of trustees of the American Association of Public Accountants, held on March 13, 1905, the following, with reference to the death of Mr. James Yalden, was ordered to be entered upon the minutes and a copy of the same sent to his family, to the public press, and to each member of the association:

By the death of Mr. James Yalden, the American Association of Public Account-

**Firms or
Corpora-
tions.**

ants has lost an efficient officer, a wise counsellor and a highly esteemed associate and friend.

Since the inception of the society Mr. Yalden has been intimately connected with it, being one of its incorporators in 1887, serving as its first president in 1888 and again, at its reorganization, he was re-elected to that office in 1892. Since that

time he has served continuously on the board of trustees until his death.

We desire to express our deep regret at his decease, and to extend our sincere sympathy to his family in their affliction.

By order of the board of trustees.

Attest:

T. CULLEN ROBERTS, C. P. A.,
Secretary.

MISCELLANY

THE CREDIT MEN'S ASSOCIATION

At a recent meeting of the National Association of Credit Men, the subject of financial responsibility being under discussion, the following timely and well advised address was delivered:

"That there is need of education on this subject to both borrower and lender is evident from the enormous losses sustained annually through the extension of credit to firms supposedly solvent; therefore, it must be a fact that positive information is often lacking.

"Inquiry is apt to be directed to the value of assets rather than to ascertaining the good will or earning power of a business, yet the latter is of more importance for, unless satisfactory, suspension is probable. In such cases book values are seldom realized, and it is poor consolation to the extender of credit to know that he must rely on such questionable security for the settlement of his account.

"There are certain ratios existing between capital, volume of business and net profits which indicate one of three conditions: First, a profitable business; second, a doubtful existence; third, certain failure. If from the reports of mercantile agencies, clearing house associations or direct inquiry the ratios referred to are supposedly ascertained, can this information be positively relied upon without verification with the books? In my opinion, there is too much time and expense consumed in ob-

taining information that is not of a positive nature.

"Credit to a large extent is obtained on statements that might be termed 'honest lies.' The executive heads of many firms have very little knowledge of accounting, and that of their bookkeepers is frequently limited to keeping the accounts in balance.

"Instances have been known where supposed profits were divided because the bookkeeper's statement showed a surplus, whereas a proper accounting would have shown a deficit, yet bookkeepers' statements are accepted by mercantile agencies without verification with the books, and by them submitted to their subscribers, together with information relating to past conditions, and on the strength of such reports credit is extended that frequently results in a loss.

"Conditions are continually changing with the class of firms seeking credit, and, therefore, information obtained under existing conditions is unsatisfactory, to say the least.

"An impression prevails that the examination of books takes up considerable time and costs an amount that would perceptibly lessen the narrow margin of profit on customary transactions. The fact is that an accountant experienced in making investigations for the purpose of determining as to the advisability of extending credit can do so in one day or less, regardless of the volume of business.

"Why not, therefore, establish, under the supervision of your association, a bureau for the purpose of obtaining information of a positive nature that will not only prevent a loss, but at the same time enable the prospective borrower to obtain the credit he is entitled to?

The information could be obtained by certified accountants experienced in this line of work or by credit men who are competent accountants. These would constitute a staff of assistants located in various sections of the country, and from the statement and report rendered by one of them the bureau could determine as to the advisability of extending the credit applied for and report its decision to the prospective lender.

"Honest borrowers would not object to confidential examinations of their books under the protection offered by the proposed bureau, as they would derive many advantages therefrom, and those still objecting when such protection is assured could be classed as undesirable risks. It is in the power of your association and the vast interests which it represents to bring about a satisfactory understanding on this subject between borrower and lender.

"There are several thousand financial, manufacturing and mercantile concerns in and near the large cities, who could profitably subscribe for the service that it is possible for you to give and furnish an annual revenue sufficient to enable the bureau to retain the best talent in the country for its staff of examiners. Thus a source of positive information would be established in accordance with the requirements of capital, and confidence would take the place of uncertainty in the extension of credit.

"To those who are of the opinion that the ideas outlined herein are impracticable, I will state that the engagements of certified accountants for direct investigation in connection with the extension of credit is

already a custom in certain progressive corporations in this city, and this service could be more economically and satisfactorily obtained through a bureau having the confidence of both borrower and lender than by individual engagements.

"It is conceded that the National Association of Credit Men is the backbone of the best business interests in the country, and these interests will naturally support any plan adopted by it to check the annual raid of \$70,000,000 on their capital."

IN MASSACHUSETTS

The annual meeting of the Incorporated Public Accountants of Massachusetts was held Thursday, February 16. Officers for the ensuing year were elected as follows: President, Frederick G. Tufts; vice-president, Harvey S. Chase; secretary, William C. Newell; treasurer, William H. Herrick; auditor, William Dillon. Members of the executive committee: Messrs. Herbert F. French, William Franklin Hall and Charles F. Kellogg. Delegate to the Federation, Harvey S. Chase; alternate to the Federation, William Franklin Hall.

The by-laws were amended in such a manner as to provide for associate members who should have all the privileges of fellows, except the power to vote, and to the right to use the title "Fellow."

It is the intention during the coming year to enlarge the society considerably both as to fellows and associates.

In addition to the business many professional and technical points were discussed and much interest shown by the members.

At the next meeting in March the question of the American association will be discussed and acted upon, and the secretary was directed to invite President A. Lowes Dickinson of the Federation and President F. J. MacRae of the New York State Society to come to Boston as guests of the Massachusetts society and address the meeting.

ELECTRIC ADDING MACHINE

The newest thing in adding machines is the 1905 Model Universal, in which are embodied many exclusively new features.

While this is an electric adding machine, it may be changed to a hand lever machine in ten seconds when occasion requires. When the machine is operated by hand a pull of only five pounds is necessary. The machine always prints two red naughts at the beginning of the list to prove that it was cleared for action when the list was started. The columns may be spaced any distance apart as the operator desires, thereby conforming to any style of ruled sheets. An individual correction key is found at the bottom of each column of keys. This permits the operator to make any correction in that column without throwing the entire item out and then re-setting.

While the Universal, when operated by hand, taxes the operator's strength less than any other machine on the market, the Universal Electric practically eliminates all physical exertion.

When you consider that an operator listing items at the rate of 40 per minute pulls a ton every seven minutes, you can form some idea of the physical exertion expended every day by the operator, who is required to list items for hours. A mere touch of the operating button, no harder than the key touch, does all of the work heretofore done by the lever, and without moving the hand from the keyboard, the reaching out for the lever being entirely done away with. On the hand machine the operator's hand travels a mile every time 5,200 items are listed.

The electric feature also makes the action of the machine instantaneous and permits of far greater speed with much less effort, physical or mental.

A further advantage of the electric machine is its increased span of life. The

pull exerted is mechanical, therefore always even, thus preventing in a great measure the wear and tear of hand operation.

These machines will be on exhibition at the Coliseum, Chicago, March 15 to 22.

A handsome 32-page catalogue, giving a further description of this most modern of all adding machines, will be sent free upon application. As a booklet, showing the mechanical progress in office appliances and labor-saving devices, it is alone worth having. Address the main office of the company at St. Louis.

INTERCHANGEABLE LEAF RECORDS

A modern locomotive and a train of modern Pullman cars looks very much like the same things looked a quarter of a century ago, and, in fact, they are very much the same. It requires a keen eye, however, and considerable imagination, to detect much similarity between the appointments of a modern business office and those in use in 1880 or even 1890. Most of the best of recent innovations have made their appearance within the last decade, and there is not a first-class accountant living to-day, no matter what his age or how confirmed in his habits, who would be content with the conveniences available ten years ago. The supplying of office specialties has grown to be an important and distinct industry, and the introduction of interchangeable leaf records is regarded by many as one of the most important events of recent times.

The Jones Perpetual Ledger Company, 14-28 Michigan street, Chicago, make the manufacture of loose leaf records their sole business. Their Perpetual Ledger was first put on the market about seven years ago, and it is now in general use by public accountants. They claim that the first Ledger installed by them, as well as all that followed it, is still in use. The Jones Company sell direct to users only, in this way insuring proper installation. Their booklet which will be sent free to readers of THE AUDITOR, gives much information of value to accountants.

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APPRAISEMENTS AND ACCOUNTANCY

BY FREDERICK A. CLEVELAND, PH.D.

It has been frequently stated that a public accountant is not an appraiser; that in the exercise of his professional duties the public accountant may never be called on to make an appraisal. While this statement as to professional requirement may be accepted, still the accountant cannot overlook the fact that accounting summaries and financial statements of assets are at their best nothing more nor less than estimates of value. In his capacity as auditor, the public accountant is bound to inquire by what warrant entries are made by bookkeepers and what is the basis for summaries drawn by bookkeepers from asset accounts. As in checking up a cash account, his audit is not ended when he finds what purports to be a voucher, as he has not properly served his client nor safeguarded his own professional reputation till he has satisfied himself that the voucher was a warrant for payment, so he cannot justify his audit of an account of stock till he has inquired into the method by which the statement of present value has been arrived at. The nature of his engagement, as well as his regard for true professional standards, requires that the public accountant should know at least the nature and purpose of appraisements, the principles governing estimates of value of different classes of estimates, and the methods commonly employed by proprietors and bookkeepers in attempting to make judg-

ments as to present values of goods, properties and assets.

THE NATURE OF APPRAISEMENTS.

Appraisal is a valuation (or estimate of value) of a property or asset, for the purpose of ex parte financial statement. The term "appraisal" is not synonymous or co-terminous with valuation; the process of appraisal is of the same nature and involves the same sort of reasoning (the end of each being to reach a conclusion called "value"), but appraisal does not include judgments of valuation made as a basis for contracts of exchange and agreements as to price. The appraiser is called in to give an opinion as to the value of assets as a basis for the exercise of administrative and proprietary judgment. Upon such appraisements of value bookkeeping entries are made, final statements of account are extended, comparisons between assets and liabilities are instituted, and deductions and summaries are drawn with respect to profit and loss, undivided profits, capital impairment, etc. For example, the balance sheet is a financial statement comparing assets and liabilities. On the one side is recorded the amount of financial obligations outstanding; these are determined by the contracts for the payment of money entered into by the individual or concern for whom the balance sheet statement is made. On the other side is recorded an estimate as to the value

of properties. The balance is also an estimate of financial surplus or financial deficit.

THE PURPOSE OF THE APPRAISEMENT AS A DETERMINING FACTOR.

Appraisements being in the nature of judgments as to value, any attempt to state governing principles must take cognizance of this fact. The principles which govern estimates of value are those which control the reason in arriving at conclusions as to value. The conclusion reached by reasoning process depends on the premises assumed, and assumptions must be premised with respect to the purposes of the inquiry. To illustrate: An appraiser may be asked to estimate the value of a \$10 United States Treasury note. If the purpose of the inquiry as to value is to determine what the note is worth as current cash in a business located in the city of New York, the appraiser may conservatively conclude that it is worth ten dollars, or ten times the value of a gold coin of the United States containing 25.8 grains of gold nine-tenths fine. But if the appraisement were made for a firm in Calcutta, such a judgment of the value of the note to the firm as current cash might not be conservative. Again, if it were to be value for the purposes of an escrow, to be delivered to a cestui qui trust twenty years hence, a still different decision would necessarily be arrived at. In the first case, the appraiser would reason that the present value of the note for trading purposes in New York would be as much as the present value of ten dollars in gold, because ten dollars might be procured in exchange on demand. In the second case he might conclude as before that the note might be exchanged for ten dollars in gold anywhere in the United States, but to estimate its current cash value in Calcutta foreign exchange conditions must also be considered. In the third case, the appraiser could engage none of the assumptions before employed—he must consider the probability as to whether

or not the note of the Government would be paid in gold twenty years hence, and then he must compound this judgment with a calculation as to what would be the present value of ten dollars to be delivered at the end of twenty years. An appraisal might be asked for a bale of clothing; but the appraiser must be informed as to whether or not the bale of clothing is to be used for the purposes of sale or as wearing apparel. If the former, then again his conclusion would be based on an estimate as to the probable amount that would be realized in the particular business for which the appraisement was made. An estimate made for an auctioneer must take cognizance of business experience in auction sales. If it were made for a retail merchant, experience might indicate that goods might be sold in the course of retail trade at a higher figure than at an auction sale. If the clothing were to be worn by the merchant, then the estimate must take this fact into account.

SOME DISTINCTIONS TO BE MADE IN CRITICAL REVIEW OF APPRAISEMENTS.

An enterprise may be in either of two business conditions, viz.: (1) It may be a "going concern," or (2) it may be in process of "winding up" or liquidation. It is very clear that an estimate of properties and equipment for the purposes of a "going concern" might give quite a different result from an estimate of value for the purposes of "winding up."

Again, there are two general classes of properties or assets of a going concern, viz.: (1) Those known as capital assets, and (2) those commonly regarded as current assets. The capital assets are those properties or belongings which are procured by means of capital and which are permanently or continuously needed in the business, such as the drains of a farm or a right of way of a railroad. Current assets are those which are procured by means of current liabilities; usually these are not continuously needed

and are not intended or set aside for use as equipment. The chief purpose of their possession is that they may be disposed of at a profit (or, in the case of credit assets, that they may be collected) and converted into current funds by means of which the current assets may be provided or the current liabilities may be liquidated.

A further distinction should be made between the value of a business as such and the value of the physical and contractual assets of a concern. The value of a business as a whole must be judged from its average present or prospective net profits. That is, the same equipment and the same capital resources and facilities for doing business may be present in each of two enterprises; the one may have a net profit of \$200,000 per year, while the other will not pay expenses. Under such circumstances, the physical and contractual assets of each would be worth the same, but the business of the one might be conservatively estimated or valued at \$2,000,000, while the business of the other might be considered worthless. A very large part of the worth of a business depends on personality, reputation, etc.—qualities which are not found in its physical properties and equipment. These may or may not appear as an asset in a going concern.

CONSIDERATIONS GOVERNING THE APPRAISEMENT OF DIFFERENT CLASSES OF ASSETS.

At this time no attempt will be made to suggest the considerations that determine whether or not "good will" and "reputation" are to be appraised as an asset, nor to indicate what premises should be assumed for the purpose of reaching a conclusion as to value when an appraisal of these is had. A few considerations are presented with respect to the valuation of physical and contractual properties.

THE APPRAISEMENT OF CAPITAL RESOURCES.

A classification which attempts to separately state capital resources presumes that

it is for the purpose of a going concern. As a going concern, it is to be assumed that an appraisal is not made for the purpose of liquidation, the only exception being the valuation of assets under lien contract of security for the payment of debt; this class will be treated later. The valuation of capital assets as such must have reference to administration and maintenance, and not to salability or final conversion into cash. The use made of such an estimate pertains in the main to capital expenditure—the amount of capital investment represented by the plant or equipment, and the protection of invested capital against future impairment by depreciation or otherwise. The original capital charges or entries in property accounts are to be determined by the initial capital outlay. Assuming that the outlay is fairly represented in the accounts, each subsequent estimate of value for the purposes of the going concern must have reference to current provisions for repairs, renewals, depreciation or loss to properties and equipment. Conservative judgment as to value, therefore, must be based on the cumulative experience of the business as to what repairs, replacements or reserves to cover depreciation and loss should be set up to protect capital invested and to forestall the distribution of dividends when there are no profits to be divided. Experience requires that after making good all losses on account of fire, flood or other accident or casualty, a proper estimate be made of "wear and tear" of each class of physical assets. It may be found that the average life of a steel rail in the service of a particular road is ten years, after which time, owing to its lightness or to abrasion, or to other causes, it must be laid aside. Pine ties may be found to last only five years. Wooden structures may be found to serve the purposes of the enterprise twenty years, while brick and stone structures may be found in the experience of the company to last fifty years. The estimate must not only be based on experi-

ence with reference to wear, but also the new or changing character of a business must be taken into account. Competition must also be considered; in fact all of the conditions necessary to success. But in a going concern at all times and under all circumstances the estimate as to value of the capital assets must have reference to administrative and proprietary ends, and not to their salability.

THE APPRAISEMENT OF CURRENT ASSETS

A property or asset which had before been used in the business, but which has been laid aside and the use of which as equipment has been discontinued, is no longer to be considered as a capital resource. Estimates of value of these, as well as of other goods or properties not to be retained for continuous use, must have applied to them the test of salability or convertibility into cash. But generally speaking, it must be considered that this disposition is to be made in the regular course of

business. Conservative estimates of value of such assets to the business as a going concern, therefore, require that the conditions under which they are to be realized on should be weighed. Scrap iron or worn-out engines may have a value to a furnace company as furnace supplies. Again, it may be necessary to consider it as market scrap. The product of the factory as a current asset may be worth its cost; again (even when it is to be disposed of in the regular course of trade), the market may have fallen to such an extent that the value of the product cannot be fairly estimated at cost. Whatever the character of the current assets, the facts and conditions to be considered are those which pertain to their salability or convertibility in the regular course of business. This is the criterion for conservative judgment as to value. An appraisalment which does not bear the stamp of such judgment should not be accepted by the public accountant.

(To be continued.)

FIRMS OR CORPORATIONS

BY E. G. SHORROCK, C. P. A.

The principal reason for the formation of an Audit Company is, apparently, the business advantage that is expected to accrue from the combination of a strong Board of Directors with a sonorous and comprehensive corporate name.

The Directors may or may not take an active part in the business, but they are expected to be "feeders," and their names are made to play a conspicuous part in the Company's advertising and are relied upon as means of influencing possible clients to whom Brown, Jones & Robinson, who, we will suppose, are the only Accountants in it and comprise the real Company, may be unknown. Without accusing Brown, Jones & Robinson of any intention of sailing un-

der false colors, it may be asked whether, in effect, this is not what they are doing.

Directors of Audit Companies either are, or are not, Accountants. If they are Accountants, then they could do their business equally well on a private partnership basis. If they are not Accountants they are, professionally speaking, out of place at the head of an Accountancy business.

It may perhaps be considered old-fashioned and out of date to insist on the importance of maintaining, in professional work, the principle of personal responsibility, but it is worthy of note that the leading firms of Accountants have maintained that principle, and that few, if any, Accountants of more than local reputation

have as yet found it necessary or desirable to convert themselves into Audit Companies.

In an Audit Company there is no personal responsibility, either to the public or to any professional body. It is not suggested that the founders of Audit Companies have been actuated by this circumstance, but the condition reached by incorporation is nevertheless the same.

A Certified Public Accountant is accountable to the body which granted him his Certificate, and it is to be hoped that as the profession grows in importance and as further C. P. A. legislation is obtained, the jurisdiction exercisable by State Boards and similar bodies will be increasingly recognized and enforced. It is difficult to see, however, that any such jurisdiction can be exercised either over Audit Companies as such or even over Certified Public Accountants who are members of an Audit Company against which complaint may be made.

In the case of a private practitioner, the cancellation of his C. P. A. Certificate, combined with expulsion from any professional Society to which the offender may belong, will, or should, have the effect of terminating his professional career, or at least of seriously interfering with it, but the Certified Public Accountant who is connected with an Audit Company may quite conceivably succeed in evading personal responsibility for the acts of the Corporation, remain free to retain his Certificate, and continue to practice either in his own name or by forming another Audit Company.

Accountants, including those who are connected with Audit Companies, are, presumably, desirous that Accountancy shall become established as one of the professions. Is the Audit Company likely to aid in the realization of that desire? To answer this, let us ask whether the Quack

Doctor Syndicates so largely advertised are held in high esteem by the educated public, and whether a Corporation of Lawyers, should one be brought into being and advertised on the same plan as some of our Audit Companies, would be likely to command a large measure of public confidence and increase public respect for the legal profession, especially if some of its directors were men otherwise totally unconnected with the Law?

The suggestion has been made that the scope of an Audit Company is wider than that of a private practitioner. It is submitted, however, that there is no purely professional work that cannot be done equally well by a private firm as by an Audit Company. Some Audit Companies point with satisfaction to their corps of engineers and other experts who are available for appraisements and similar work. But surely Audit Companies do not possess a monopoly of such experts, whose services are equally at the disposal of, and as a matter of fact are frequently made use of by, private firms. Neither is the Audit Company, as such, any more competent than the private firm to undertake work on a large scale.

To sum up, it is submitted:

1. That in the formation of an Audit Company the objects in view, or attained, are

- (a) An ornamental Board of Directors and a comprehensive Corporate name to be used for advertising purposes.
- (b) The limitation of financial responsibility.
- (c) The evasion of professional responsibility.

2. That the corporate principle is injurious to Accountancy as a profession.

3. That a Corporation is in no way more competent professionally than the private practitioner.

SOME SPECIAL POINTS IN ACCOUNTANCY PRACTICE

BEING A LECTURE GIVEN ON MARCH 8 BEFORE THE SCHOOL OF COMMERCE, ACCOUNTS AND FINANCE, NEW YORK UNIVERSITY

BY ARTHUR LOWES DICKINSON, M. A., F. C. A., C. P. A.

(Continued from March issue.)

At January 1, 1901, the total valuation might have been expected to amount to \$552,500, being the valuation of July 1, 1900, with the addition of \$27,500 undivided profits. At February 28 it actually amounts to \$52,500 in excess of this amount. This increase is found by comparison with previous statements to be made up as regards \$50,000 of increase in capital assets over and above the actual additional expenditures involved, and as regards \$2,500 it represents the profit for the two months of January and February, 1901, which is so much less than that in previous periods as to call for further investigation. The fact is then disclosed that liabilities for expenses, etc., chargeable against the period previous to January 1, 1901, had not been provided for to the amount of \$2,500, and also that the inventory of manufactured products on hand at January 1, 1901, had been valued at market price instead of cost, while those at the end of February had been valued at cost. Fortunately, the inventories of January 1 are forthcoming and the cost values are approximately ascertained, showing an excess valuation at this date of \$10,000, and correspondingly increasing the profits for the two months ending February 28, which are thus found to have amounted to \$15,000.

The corporation, however, claim that they are also entitled to treat as profit the increased value given to the capital assets in excess of book figures, on the ground that if they were willing to purchase on the basis of the July, 1900, balance sheet for

\$900,000, they have made a profit by acquiring assets to the value of \$50,000 more than they expected. Here again the question of contract must be considered. What was purchased was a business as a going concern, and not necessarily in the actual condition, as regards value, shown by the July balance sheet. An expression of values in figures is at best an estimate, more or less accurate, while the price paid is an actual tangible fact. Whatever physical property is acquired under the contract must be held to be the exact equivalent of the price paid. If it eventually appears that there is more or less value than was supposed, so much the better or worse for the purchaser, but the fact remains that he paid a certain price for a certain property. If the tangible assets acquired turn out to be greater or less, the intangible asset of good-will must be less or greater by an equal amount. Hence, in the present case, the overvaluation of \$10,000 in inventory and the undervaluation of \$50,000 in capital assets represent a net reduction of \$40,000 in the amount paid for good-will, which is thus found to amount to \$307,500. Finally, as a result of these various adjustments, the balance sheet at January 1, 1901, is ascertained to be as follows, and upon this basis the books of the new corporation should be opened:

Capital Assets—

Land	\$ 50,000
Buildings	100,000
Fixed plant and machinery	200,000
Loose tools.....	30,000
	————— \$380,000

Current Assets—

Inventories of manufactured products, stores and material.....	112,500		
Accounts receivable....	95,000		
Cash	28,000		
			235,500

Less Current Liabilities—

For accounts payable	\$20,500		
For interest to vendors	2,500	23,000	212,000
			\$592,500
Leaving to represent good-will...			307,500
			\$900,000

The overvaluation of inventories found to exist above is a frequent occurrence on the sale or transfer of a business. In selling stocks of material, and partly and wholly manufactured products on hand, the vendor is clearly entitled, in default of any provision to the contrary, to claim the full market price. On the other hand, the purchaser, if he pays the full market price, runs the risk of making no profits, or even of making a loss on the realization of these products. Hence, it is usual for the contract to contain a provision that the goods on hand shall be valued at cost; in the case under consideration, either this was not the case or proper care was not exercised by the purchaser in examining this asset. But cost is the correct basis, and the adjustment made in the case under consideration is the only fair way of dealing with the matter.

Accounts receivable should be, and usually are, guaranteed by the vendors to the full amount, but if not, a loss may be incurred on the realization thereof, and this again would mean that the corporation had paid less for book debts and more for good-will than it originally anticipated. Similarly, if the liabilities eventually found

to be payable exceed those stated in the balance sheet on which the contract was based, and no recovery were possible from vendors, the excess would mean a further addition to the price paid for good-will.

In theory the hagggle of the market settles the price as between an independent seller and purchaser, and although in the formation of the large majority of modern corporations, through the intervention of syndicates, the vendors and purchasers are one and the same, the only safe and sound method of accounting is to assume that the same principles applies as in the case of a bona fide sale, and it is probable that in every case in which the organization is thoroughly sifted by the courts these principles would be upheld.

In our assumed case it will be noted that the corporation were easily able to adjust the accounts to a proper basis, as the books were well kept and the inventory valuations at previous dates were available. Unfortunately in practice this state of affairs is the exception rather than the rule, and it is consequently often a matter of great difficulty to arrive at any basis for a proper adjustment, even when it is obvious that the books do not disclose the real facts. It is in such cases that the experience of the public accountant stands him in good stead, and a knowledge of where to look, and of the elements involved, enables him to arrive at a substantially correct solution.

In concluding the history of our imaginary corporation, the following may be suggested as a useful exercise in book-keeping, viz.: Assume that the company has already opened its books on the basis of the July, 1900, balance sheet, and had taken credit in its profit and loss accounts for the profits earned during the six months to January 1, 1901, and then make the necessary journal entries to correct their books and bring them into accord with the final adjusted balance sheet of January 1.

INVENTORY VALUATIONS.

Important accounting principles are involved in the accurate determination of inventory valuations. Profits can only be made out of a sale, or exchange of one commodity for another of a definite and realizable cash value. The mere increase in the market value of an article which it is not intended to sell at that time, cannot be considered as a profit, for the reason that the article may never be sold at that price and the paper profit may never be realized. The object of the profit and loss account of a manufacturing or trading concern is to ascertain as closely as possible the profits which have been realized on sales actually made; and for this reason raw materials on hand and products partly or wholly manufactured, but not sold, should be entirely eliminated. In practice this result is obtained by valuing them at cost, no more and no less, and so exactly offsetting the materials, labor and expenses charged to profit and loss account, in so far as the result of their combination in manufacturing processes is still uncompleted and unsold.

On the other hand, a balance sheet is required to show the true financial position as a going concern. The inventory at actual cost may represent more or less than the market value, and, therefore, overstate or understate the assets, but to change the valuation would be to take up a profit or provide for a loss which might never be realized owing to subsequent changes in the market value. Sound commercial principles require that no credit be taken for profits until they are realized, and, further, that if there is any possibility that what remains unsold may not realize its cost, a proportion of the realized profits on sales which have been made should be carried forward to cover these possible losses. It is accordingly generally recognized as a sound accounting principle that if the cost value of the inventory exceeds the market

value, a reserve should be created to bring it down to that value, while, on the other hand, if the market valuation exceeds the cost, no credit should be taken for the profits until they are realized by an actual sale. This rule is of considerable importance where the inventories at the end of successive years show a progressive increase. If they be valued above cost, profits are shown each year, which are in anticipation of those of succeeding years, and a large fictitious asset is created, which, by a subsequent fall in market values, may be entirely valueless. In a quite recent case the directors of a corporation have been held personally liable for a sum of \$1,000,000 in respect of dividends distributed to stockholders out of fictitious profits created in just this way.

The importance of a valuation at cost emphasizes the necessity of such a system of accounting as will enable cost to be accurately ascertained. The theory of cost accounting is merely an elaboration of ordinary bookkeeping, and its difficulty lies almost entirely in a correct ascertainment of the elements that enter into it. There is no theoretical difficulty in keeping a record of the number of hours, human and machine, and the quantity of material that enters into any process of manufacture, but the practical difficulties arise from the large number of operations, the chances of error in the tabulation of hours worked and quantities consumed, loss of weight in process and many other minor points, coupled with the necessity of an economical operation of the cost accounting system.

Up to this point no questions of principle arise. But there are innumerable other expenses which cannot be allocated to any particular operation and yet are essential to all operations, such as steam power, light, heat, taxes, insurance, general supervision and cost accounting; and the determination of the proportion in which these expenses should be distributed to the different proc-

esses is a problem which is incapable of an absolutely accurate solution. Almost every business differs in this respect, and various methods are adopted for arriving at an approximation to the result. The one essential is that the total amount absorbed in the cost over any period should not materially exceed, or fall short of, the total of all such expenses incurred during that period.

A further difficulty lies in the fact that it is not always possible to draw a hard and fast dividing line between expenses directly chargeable to manufacture and expenses not so chargeable. There are expenses of supervision, bookkeeping and general management, which cannot be specifically divided between the different departments of manufacture, sale and collection, and the general management of the corporate organization. The first division only would enter into the cost of manufacture, while the second and third would be chargeable only against the gross profits resulting from the sales, and the fourth would be chargeable against the profits of the whole undertaking. A thorough understanding of the business, a careful analysis and apportionment of the duties of individuals, and a general knowledge of the manner in which each item of expense affects the different departments is necessary to arrive at even an approximate division, and at best the basis adopted is somewhat arbitrary.

The question continually arises whether interest in any form should be considered as part of the cost of manufacture. It is true that manufacture takes time and involves the lock-up of money for certain periods, and that this money should for those periods be earning interest. On the other hand, it must be remembered that interest is only one form of profit, that the object of any business is to earn profit, that each operation, as well as each department, is only one in a series, none of which is complete in itself, and the whole of which

are necessary to the complete process of manufacture and sale, out of which alone can any profit be earned. To charge interest into costs is in effect to add to those costs a certain amount of profit before it has been made, and is, therefore, against sound commercial and accounting principles. It is sometimes claimed that as interest on loan capital, from the point of view of the owner or stockholder, is an expense, it therefore should be treated as part of the cost of manufacture, but such a contention entirely loses sight of the fact that such capital is raised for the purpose of conducting the business, and is remunerated by a strictly defined share of the profits earned in that business. It is true that interest is usually payable, whether there are profits earned or not, but it must ultimately be met out of profits, and it is merely one of the incidental conditions of the loan that the lender is to be paid his share of the profits at regular dates, and frequently in advance of any such profits being earned.

Here it may be well to point out a distinction which should be more widely recognized than it is between the profits of an undertaking and the profits of a particular section of these who contribute the capital required, as for instance the stockholders of a corporation. The profit of an undertaking is the difference between the sale price and the cost of its products after deducting therefrom the expense of disposing of the same. The manner in which the capital is raised cannot affect the profit in any way, but merely the distribution thereof between the different interests by whom the capital is contributed, or, in other words, interest on borrowed capital is as much a part of the profit of the undertaking as is dividend on capital stock of a corporation, or the profits which accrue to the individual owner.

The accuracy of the periodical statements of earnings of manufacturing con-

cerns depends to a large extent upon that of the inventory, both as to quantity and value. Without such an inventory it is impossible to ascertain the earnings, and yet the delay and expense involved prohibit a physical taking thereof at short intervals, which in most cases would necessitate a complete shutting down of the works for a period some times of weeks, and a consequent loss of business. Up to comparatively recent times it was the practice to take such inventories once a year, closing the works at a suitable date for that purpose, but the demand on the part of directors and stockholders for more frequent statements of earnings has necessitated some method of arriving at the approximate value of stocks on hand without the expense and delay involved in a physical enumeration thereof. The skill of accountants throughout the country has by degrees evolved a system of book records continuous throughout the year, of materials, work in process and manufactured products, and enables a book inventory to be taken each month so accurately that the closing down of large works for this purpose is now, unless in exceptional circumstances, almost unknown.

These book records consist of accounts, both of quantity and value, kept for each class of material and manufactured product, based on accurate returns of the quantities received and consumed, and time expended, and balancing with the principal books, so far as money values are concerned. The quantity and values of receipts are obtained from the original bills, analyzed and charged to the respective store accounts. The consumption records are obtained from a very large number of small individual records of time and material expended in the various productive operations; these are collected together, classified and summarized, and charged and credited to the respective production and material accounts on ordinary book-

keeping principles, with the result that the balance left on any material account represents the quantity on hand, and the balance on any production account after crediting the finished product represents the value of the uncompleted work.

It might be supposed that the consumption reports made up by workmen, often illiterate, and with no idea of the purpose for which the records are required, would be so inaccurate as to be useless for practical purposes, but a little consideration will show that, apart from any deliberate attempt at falsification, errors would tend to offset each other and the resulting difference should be comparatively small in proportion to the totals involved. In fact as in so many other problems of everyday life, the principle of averages obtains, and the final results as a rule are found to be surprisingly accurate if ordinary precautions are adopted.

As any particular material in stock is reduced to a low point, a physical inventory thereof is easily taken, compared with the book records, and any discrepancies adjusted, and by this means almost the whole of the material accounts are verified physically at least once in the course of each year without any interruption of the ordinary business. In the case of large bulk stocks, such as ore, pig-iron, etc., the problem is a more difficult one, because it may be, and frequently is, a period of some years before the piles in which these articles are kept are reduced to a sufficiently small quantity to enable any accurate inventory to be taken. In these cases, however, it is usual to allow a small extra percentage on the consumption to cover waste or loss, with the result that in practice the physical test more often shows an excess over the book record than otherwise.

Material in process of manufacture can usually only be physically verified when the process is entirely completed, which

may be after weeks, months, or, in large contracts, even years. But by a subdivision of accounts into different processes and small units, the book records are being continually verified at each end, that is, by the labor and material which is known to have gone in and by the finished product which is known to have come out, and provided that the values at which the material is charged in, and the finished product credited out, are approximately in accordance with the facts, the resulting balance of work still in progress must be substantially correct also.

In all these accounts the month is the unit of time most usually adopted, and the value at which a month's consumption of material should be charged out is of some importance. The safest rule is to assume that the stocks at the beginning of the month are first exhausted, or, in other words, to bring down the stock at the close at the cost of the receipts for the month, up to the amounts of such receipts and for the balance at the commencing value; the balance of the account representing the cost of the quantity consumed. But this rule requires to be followed with care, because it might happen, for exceptional reasons, that the cost for that month was either very much above or very much below the average, and that the stocks should be adjusted to a more normal valuation.

The system here roughly outlined has not only obviated the loss and expense involved in taking a complete physical inventory once a year, but has also enabled book records to be maintained of sufficient accuracy to justify the declaration of dividends out of profits so ascertained.

CONSTRUCTION EXPENDITURE.

The problems involved in the consideration of the proper charges to be made for construction work are:

1. The correct ascertainment of the actual labor and material expended thereon,

which, if proper records be kept, is a comparatively easy matter, and

2. The determination of the amount, if any, which should be added to these direct costs for general and management expenses, and possibly for interest. In a going concern a conservative course is generally adopted, and no additions are made to the labor and material cost for expenditure of moderate amounts on additions to the property, while, on the other hand, if a new and distinct plant were in course of construction, and producing no earnings from operation, the whole of the administration expenses and the interest paid on loans raised for this especial purpose would necessarily be charged to construction account, and rightly so, being necessary elements of completing the work. This at once raises the question that what is reasonable and proper in the latter case should also be reasonable and proper in the former, particularly if facilities are employed which would otherwise be available on profitable work for outside parties.

It must, however, be remembered that profits can only be made out of the sale of products, and that it is, therefore, incorrect that a concern should take credit for profits on work which is not intended for sale, and will, in all probability, never be sold as long as the concern is continuing to carry on business. It would follow then that no charge should be made to construction for expenses which would have been equally incurred if there had been no such construction, and would in that case have been charged against profits, although if special loans have been raised to provide funds for construction purposes, and a special staff of employees is maintained for this sole purpose, it would seem quite legitimate that the interest paid on such loans, and the salaries of the special staff, should be charged to construction account until the work under construction is in full operation. Any other method

might result in the creation of paper or fictitious profits, which would not be realized as long as the property was operated, and might never be realized on an ultimate sale thereof. A good instance is the case of a railroad building large extensions, the material for which in considerable quantities is carried over its own road. The freight on this material forms part of the earnings of the road, and if the new construction bears a large proportion to the mileage in operation, the earnings would be swelled to abnormal proportions by the additional traffic so created, and the road will appear, for a short period, to be earning profits entirely out of proportion to those derived from its normal operations. The whole of this increase is really fictitious and does not add to the value of the stock in any way.

Managers of the operating departments of a factory frequently claim that they should be allowed to charge a profit on construction work carried out for their own mills, on the ground that if the work were done outside they would have to pay a profit, and at the same time would set free their own facilities to carry out additional work at a profit for outside customers, and they even go so far as to say that if they cannot charge a profit on construction work carried out, they will in future have the work done on outside contracts. It must be admitted that this is a plausible argument, but a little further consideration will show that it is fallacious. There is here a confusion between a profit and a saving. The reason that a concern undertakes its own construction work in place of letting outside contracts therefor, is that it can by that means effect a saving in its expenditure by taking advantage of its own capital and facilities to carry out the work instead of using the organization and the capital of others, upon which it would have to pay a profit. The saving so effected is of considerable advantage, in that it reduces

the amount of capital invested and its future earnings will represent a larger return on the investment. Moreover, it is seldom true that the use of its own facilities for construction expenditure really means the throwing away of profitable work for outsiders, which would otherwise have been undertaken. It is doubtful if any well managed concern ever refuses profitable orders, because of its own construction work. Its organization can and will almost automatically expand sufficiently to provide for any increase in its operations which is likely to be thrown upon it. Moreover, if a sum be added to the cost of construction and credited to profit and loss, to represent the profit which would have been earned by the company if the work had been done for outsiders instead of for itself, this profit can only be made available for distribution by increasing the amount of capital contributed for the new construction work, and it can hardly be considered good financial policy to increase indebtedness for the purpose of paying dividends. The only sound principle that can be adopted is to charge to construction all costs and expenses which are directly attributable to that construction, but nothing for indirect expenses, interest or profit.

MAINTENANCE AND DEPRECIATION CHARGES.

The sufficient provision continuously for the wear and tear of property due to operation is a subject of daily concern to the accountant, and of vital importance to the investing community. There are many undertakings which can be carried on for a long period of years without any apparent damage, upon small expenditures for the keep-up plants, but there is always an insidious and unseen waste going on day by day and year by year, which must sooner or later result either in reduced efficiency or in largely increased expenditure on renewals. During these early years large profits may be shown and even perhaps

distributed, until the increasing cost of production, owing to lower efficiency of the plant, or the increasingly heavy cost of maintenance to keep the plant efficient, may turn those profits into losses, and leave the undertaking in a dangerous financial condition. It is not many years since the railway industry was reduced to such a condition, largely owing to these causes, and while more conservative policies are now in fashion, there are signs in other directions, and particularly in electrical enterprises, of a recrudescence of this vicious principle. And yet, if sound accounting principles were adopted, and the theory of the wear and tear of plant and machinery were really thoroughly understood and lived up to, there would be no necessity for any such condition. Where the exact cost of the construction assets of a concern is known, which it always is at some point of its history, it is a comparatively easy matter for the accountant, either as a result of his own experience or in consultation with engineers, to determine approximately a conservative and safe term of years to represent the probable average life of different classes of plant, machinery, etc., on the assumption that ordinary recurring repairs are made from time to time and charged to operating expenses. On this basis provision should be made each year for renewing the proportion of the original cost equivalent to the estimated life, so that by the end of that term the

whole is provided for. If this provision be carried to the credit of a renewal fund, any expenditures incurred for renewals, replacements or improvements on these assets which increase the life thereof, should then be charged against this fund. This is the theory, but, unfortunately, it is difficult to carry it out in practice. In corporations particularly, it is often a matter of impossibility to ascertain the actual cost of the different classes of assets, mainly from the neglect of sound principle of accounting. The owners may wish to be conservative, and will charge to the operations of a year the cost of improvements and additions which increase the capacity of their plants, keeping no records thereof in their books, or, on the contrary, they may wish to inflate their profits and will charge all their repairs to the asset account. Both cases are frequent in practice and both are equally to be condemned. Again, if an undertaking has been sold by the original owners to a corporation, and that corporation has again been absorbed by another corporation, and so on, the original cost and values are entirely lost in one large total, including physical assets, good will and promoters' profits, and, as valuations in such cases are rare, neither the original cost nor the present value, nor even the classification of assets, can be obtained, either from the books or any other records.

(To be continued.)

POSSIBILITIES OF THE PROFESSION

BY ERNEST RECKITT, C. P. A.

The Profession of the Public Accountant is the product of modern methods of transacting business and also of that keen competition which makes itself felt in every line of trade and commerce. It may be stated that the Public Accountant stands

in the same relation to all matters affecting the organization and supervision of records of accounts and costs that the Architect bears to the erection of a building. As the Architect must be equally familiar with the construction of a cottage, a hos-

pital or a factory, so the Public Accountant must have an intimate knowledge of the best forms of accounts in all classes of businesses, and when engaged upon a critical examination of same, must know where to expect to find the weak places where losses may occur. It is not expected of the Architect that he should be a bricklayer or a plumber, neither must the Public Accountant be necessarily expected to be a bookkeeper in so far as the mere keeping of the records is concerned or the speed with which he might add a column of figures or make a given number of postings. Like the Architect, the Public Accountant is a designer and creator, but instead of designing buildings he organizes and creates systems of accounts and costs, and from his knowledge of the needs of his client he obtains all the required information from various sources with the minimum amount of labor and brings it together into concise and valuable statements that any layman can understand and appreciate.

The rapid growth of this profession in this country during the past few years and its increasing appreciation on the part of the public, makes it one which should appeal to young men who are naturally endowed with those qualifications which constitute a Public Accountant, and who are in doubt as to what line of work to enter upon. The professions of law and medicine are already overcrowded, the investment of capital in a small business is becoming daily more hazardous, so that the fact that so few college men enter the profession of Public Accountancy is undoubtedly due to its being one of comparatively recent date, and because they are ignorant of the excellent opportunities that this field of work opens up.

The opportunities for success in this profession, however, are not due to any less exercise of energy, application and study, than in other professions, but is solely on account of the many calls on the

part of the public for the highest class of service that an accountant can give, and this demand being in excess of the present supply. Mediocre or second-rate ability will no more contribute toward success in this profession than in any other line of work, but what *is* claimed is that to men of ability the chances of securing a comfortable income are more favorable than in other professions. Furthermore, his training fits him to occupy most profitable and responsible positions outside of the Accountancy profession to a far greater extent than in other professions.

Having discussed briefly the opportunities of the profession from a material standpoint, it may not be out of place to speak a few words as to the standing of a Public Accountant among his fellow men. Every young man of ambition wishes to feel, and rightly so, that he is entering upon a business or profession which stands high in the regard of his friends and associates. For the profession of Accountancy as it is to-day, no apologies are necessary. The relation which exists between the Public Accountant and his client is a personal one, involving on the part of the former an intimate knowledge of all of his client's most private affairs. The Public Accountant must therefore have a reputation above reproach, to be worthy of the confidences reposed in him. Furthermore, the work which an accountant is employed to perform requires a higher order of skill and ability than the man of mediocre attainments could cope with. Therefore both as regards to personal character and brain capacity, only the best of each is good enough for the accountant who would be successful.

The meaning of the term Public as a prefix to the name Accountant has often puzzled those who have not had its cause explained, and a few words on this subject in this place will further elucidate the duties of the Public Accountant. One of the

most important functions of the Accountant and Auditor is to certify to the accuracy of statements representing the financial conditions of businesses both as to their present Assets and Liabilities and their past Profits and Losses. Whether these certificates be published or only used for private circulation, the public is deeply interested, for from the presentation of the figures certified to, the value of the business or of the capital stock of a corporation will largely depend. Fortunes may be lost or made by errors creeping into such statements, or, as Mr. Lawrence R. Dicksee, a widely known Chartered Accountant of England, puts it: "Auditing is much too serious a matter to be trifled with; the evil that can be wrought by an incompetent auditor is hardly less vital, and is infinitely more extensive, than that which may be exercised by an unqualified medical practitioner. The latter, if he be the possessor of an extensive practice, may poison a hundred or so patients in the course of his career; but the former can, while merely confining his attentions to the affairs of one undertaking, readily accomplish the ruin of tens of thousands in a much shorter period."

Realizing the necessity of the public having some means by which they can discriminate between the qualified public accountant and the unqualified public accountant, the legislatures of the states of New York, New Jersey, Pennsylvania, Illinois, Maryland, California and Washington have all passed laws creating the title of Certified Public Accountant, and granting same upon due examination to all such as can show that they are qualified. The laws as passed by these states are not restrictive in their character, as they do not prevent any person from practicing as a Public Accountant, except that only those who have duly passed the examination can term themselves "Certified Public Accountants," or use the abbreviation "C. P. A." after their name.

In the state of Illinois, the University of Illinois is the body that is empowered to hold examinations and grant degrees; the qualifications being that the applicant must be a citizen of the United States or have declared his intentions of becoming a citizen, and be over the age of twenty-one; he must have received a high school education or its equivalent, and be a man of good moral character. He must also successfully pass examinations on the following subjects: "Practical Accounting," "Theory of Accounts," "Auditing" and "Commercial Law."

The students of law or medicine must pass examinations successfully before they practice as lawyers or doctors, so that the public may be protected against those who are unqualified, hence the value of placing the Public Accountant on the same footing is too obvious for further comment, except to state that the effect of this law is to give to the Certified Public Accountant a professional standing which very properly should increase his responsibilities.

To the young man who after reading the above paragraphs may desire to prepare himself for this profession, some few words as to those qualifications which are not obtained by study, but which rather form a part of his character, may now be addressed. It is, of course, assumed that the candidate has a natural love of figures and that he is well versed in mathematics, and preferably also in algebra and geometry, as a training to his reasoning faculties. To these qualifications should be added a large fund of common sense, caution and patience, whilst accuracy in his calculations and modes of thought and reasoning are absolutely essential. The man who will accept as correct the figures as they appear on books of account because they contain no clerical error, or who will too readily accept explanations given, without further investigation, will never succeed as an auditor. It is necessary to know the reason of every step taken, and,

once satisfied that a given result is the true one, the accountant should have the courage to stand by it.

In addition to the study of textbooks and those natural qualifications which have been referred to above, experience must be gained by actual work in an accountant's office. In no other manner can any man prepare himself for those duties and responsibilities which he will later be called upon to bear, after he has duly qualified himself as a Certified Public Accountant. During this period of apprenticeship in the profession, as it may be termed, he will be called upon to perform a considerable amount of routine work which at times may appear irksome, but which will give him a thorough foundation in the principles of accounting and auditing. As his experience

increases, new duties will be given him, it being the careful duty of his employer never to place more responsibility on his shoulders than he can stand. In no other manner can he obtain the wide and varied experience in all the branches of the profession that is necessary to success.

In conclusion, nothing better can be quoted and more to the point than the following paragraph out of Dicksee's *Work on Auditing*: "Accountancy is a profession calling for a width and variety of knowledge to which no man has yet set a limit; the foremost accountants are not ashamed to say that, like Epaminondas, they 'learn something in addition every day'; let us, therefore, see no shame in following their example."

MISCELLANY

THE "FURNITURE MAKERS" AGAIN

We were recently shown a small pamphlet entitled "Association Accounting," purporting to describe the best system of accounts for Young Men's Christian Associations and similar organizations, ending, of course, with the suggestion that the authors be communicated with and be given an opportunity to demonstrate the phenomenal advantages of their system of accounts. The peculiarity of the pamphlet was that no names were given nor any address except a postoffice box in Chicago. When the blanks for the system were ordered by one of the departments of the local Y. M. C. A. they bore the imprint of the largest of the stationery-selling so-called accounting companies, who professed not to know for whom they had been printed.

It looks as if this were an artful dodge on the part of the commercial accountant company, and, as if they were masquerading under a name that was better calculated to catch the associations than their own. They

may have begun to realize that their own name is becoming a little shopworn.

A GOOD THING

In our advertising columns there will be found offered a Dictionary which should be in the office of every business man and every practicing accountant. The quality of language used in correspondence often secures or loses an engagement.

ACCOUNTANT MADE RECEIVER

By special request of Charles L. Gauch and Mrs. Sophia Gauch, widow of Jacob Gauch, Vice-Chancellor Stevens to-day appointed Frank G. Du Bois receiver of the Jacob Gauch Box Company, East Mechanic and Bruen streets. The appointment was made to close the business, the concern being entirely solvent, the two parties to the suit being merely formal litigants.

The appointment of Mr. Du Bois is the first time the Chancery Court has formally recognized the certified public accountants

of New Jersey. Mr. Du Bois was the selection of both Mr. Gauch and his mother, Mrs. Sophia Gauch. The court directed that the receiver carry on the business for one week and then make application for further instruction. George M. Titus appeared as counsel for the parties to the suit.—Newark Advertiser.

THE CALIFORNIA SOCIETY

The annual meeting of the California Society of Certified Public Accountants was held on Wednesday evening, March 1, and the following officers were elected for the ensuing term: President, Alfred G. Platt (re-elected); vice-president, Norman McLaren; secretary-treasurer, Lester Herrick (re-elected); directors, E. E. Bostwick, J. F. Foster, Percy G. Good, J. J. Hassel, F. G. Phillipps, A. Wenzelburger.

ANNUAL MEETING

The annual meeting of the Illinois Society of Certified Public Accountants will be held at 314 Royal Insurance building, Chicago, on Tuesday, April 25, at 2:30 p. m.

At this meeting will be held the election of officers and directors for the ensuing year, and other business of interest will be transacted.

IN NEW JERSEY

Annual meeting of the New Jersey State Society of Certified Public Accountants was held Saturday, January 14, at Cafe De Jianne, Central avenue, Newark.

Lunch was served to the seventeen members present. The inner man being taken care of, recreation was suspended and the members buckled down to business. Officers elected for 1905 were:

President, W. Sanders Davies, C. P. A.
Vice-President, Frank G. Du Bois, C. P. A.
Secretary, August Hartkorn, C. P. A.

Treasurer, Elmer B. Yale, C. P. A.

Trustees, Richard F. Stevens, C. P. A., and George Forman, C. P. A.

Vote of thanks passed and extended to the retiring president, Richard F. Stevens, C. P. A., for his faithful services for the past seven years.

A resolution as follows, offered at a previous meeting by Frank G. Du Bois, C. P. A., was reported back from committee and passed:

Whereas, The New Jersey State Legislature did enact a law, Chapter 230, Laws of 1904, recognizing and regulating the profession of Public Accountancy and did establish the degree of Certified Public Accountant and

Whereas, Said degree does give value and dignity to our profession and

Whereas, It is the desire and the aim of this society and of all of its officers and members to maintain the value and the dignity of the degree of Certified Public Accountant on the highest plane possible and

Whereas, It is further the desire of this society to profit by and abstain from the errors made by Certified Public Accountants of other states as to the improper use of Certified Public Accountant or Accountants, or the letters, C. P. A. Now, therefore, be it, and the same hereby is,

Resolved, That the Society of Certified Public Accountants of the State of New Jersey disapprove of the use of the letters C. P. A., or the words Certified Public Accountant, or Certified Public Accountants, except in the manner following; that is to say, the letters C. P. A. or the words Certified Public Accountant to be used only as a suffix, appended to or in connection with the name of an individual, the holder of a duly authorized and unrevoked certificate or commission issued to said individual by law, and the words Certified Public Accountants, being the

plural, to be used only in the case of a firm or association where all the members thereof are holders of duly authorized and unrevoked certificates or commissions, and be it further

Resolved, That this society disapprove of the use of C. P. A.—Certified Public Accountant or Certified Public Accountants—in any other manner, connection or form, or for any purpose or purposes, other than as set forth as above.

The American Association of Public Accountants, at a meeting held January 10 in New York City adopted a revised Constitution, thereby creating a central body and bringing together all state societies, each as an integral part of the whole, for the better protection and the advancement of public accountancy in the United States.

The New Jersey Society, by unanimous resolution, instructed its secretary to at once apply for membership, thus New Jersey being the first to avail themselves of this important opportunity.

By unanimous vote the board of trustees were instructed to revise the constitution and by-laws, and further a motion was passed increasing the annual dues, both of these measures becoming necessary in order to join the American Association of Public Accountants.

HOSPITAL FINANCE

The directors and managers of the various hospitals that are hampered in their work by lack of funds to meet their running expenses should pay particular attention to the remarks that were made by Dr. John W. Brannan on Thursday at a conference in the United Charities building. Dr. Brannan pointed out that American hospitals are the only institutions in which modern methods of bookkeeping are not followed. It is frequently impossible to learn from the books how the money disbursed has been expended, and

the public is always in the dark as to the economy or extravagance of the institutions that it is asked to support.

An examination of the books of the London semi-private hospitals ten years ago disclosed the fact that in several cases the accounts were kept in such a manner as to produce a deficit on the annual balance sheets, the purpose being to encourage public giving by raising each year a cry of poverty and debt, when in reality none existed.

Dr. Brannan also declared that the hospital authorities were wasteful of bandages, dressings and the like, to a degree unknown in private practice, and he made the pertinent observation, "Less waste and you'll get more money from the people," addressing himself to the hospital managers who were present. It is obvious that with a proper accounting method in force the waste of material would be cut down immediately, for leaks would soon be discovered and stopped that are now unknown to even the most conscientious and hard-working superintendents.

The men and women interested in New York hospitals have still another reason for adopting an approved system of bookkeeping. The revelations of improper conduct on the part of some hospital boards, made five or six years ago, disturbed public confidence in all of them. When it became known that some institutions were deliberately robbing the city, many persons decided, unjustly, but perhaps not unnaturally, that most of them were, and this belief has not yet been eradicated from the public mind. Modern bookkeeping would show the truth about each hospital. Once this was known, the worthy ones would find little difficulty in obtaining funds sufficient for all their purposes. The unworthy ones would receive nothing, and that is exactly what they deserve and should receive.—The New York Sun.

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Articles appearing in THE AUDITOR are not to be read as having received the endorsement of the society, but are to be taken as individual expressions of opinion, and as such may be answered in future issues. The Editor invites contributions from all Accountants.

A new field for the Accountant appears to be appreciated by some Chicago Bankers, who, upon application of one of their borrowers for renewal of their paper, and who is suspected of financial weakness, immediately send for a Certified Public Accountant to carry out a thorough investigation of his books of account, and upon the report of the Accountant decide whether to make or renew such loan. This procedure, of course, cannot be carried out without the consent of the borrower, but his refusal to open his books for inspection is tantamount to the confession of financial weakness, which no person could afford to exhibit. For the most part at the present time the Bankers have to be content with Mercantile reports, and such other hearsay information as they may be fortunate enough to obtain, in deciding whether the loan will be safe or otherwise. The statement of Assets and Liabilities included in the Mercantile report is, generally speaking, not certified by the party making such statements, and it goes without saying that anyone desiring to effect a loan looks at the condition of his affairs in a very different manner from the Accountant or outsider who is disinterested.

A recent experience demonstrates the

dangerous position in which a bank is often placed unless the services of a Certified Public Accountant be called into requisition. A firm of Certified Public Accountants was recently instructed by one of the largest banks of this City to investigate a certain firm which was desirous of renewing a loan of \$5,000. The bank was carrying this firm to the extent of \$18,000, of which only \$8,000 was secured. This investigation brought to light the fact that while the firm started fifteen months prior with a capital of \$27,000, it had, by mismanagement and poor trading, made a loss during that period of \$33,000.

Only two courses lay open, either bankruptcy or the acquirement of fresh capital. The father of one of the members of this firm put in the necessary capital and the bank's loans were repaid.

If all Bankers appreciated the value of the services which could be rendered in such cases by the Certified Public Accountant, there would be a large diminution in the losses reported every year due on account of loans being made without proper information as to the financial ability of the borrower.

A very interesting and important question is involved in the treatment of what is usually known as Treasury Stock. It is a common custom to consider the entire capital stock as fully paid when it is given for a mining claim, patent-right or similar property. Assuming for the time being that this does actually pay up the stock, what is the effect of the placing in the treasury of an amount of stock donated by the original vendors of the property? It is claimed by some that the turning back of the stock to the company acts as an extinguishment of the stock and of all the equities in it and that when the stock is sold at a discount it is not a re-issue of

Treasury
Stock.

the same stock, which has been fully paid, but an issue of entirely new stock. If this view is correct, every purchaser of this stock is liable for the difference between par and the amount he has paid, and this makes the question a very important one. We would like to have the opinions of different accountants on this subject and will welcome a discussion of it in our columns.

Many well-informed business men view with genuine alarm the movement toward public ownership and operation of street railways and other utilities. Business principles have never mixed with politics in this country successfully, so that there is reason for the alarm so freely expressed. However, if the people take hold of the matter in the proper way, and absolutely refuse to let political advantage have a place in the decision of what are purely business matters, success should not be impossible by any means.

The cause of this movement can be traced directly to the "business men" who have heretofore engaged in the business of lighting and transportation. If they had been content to capitalize their undertakings at the actual cost of construction and equipment, with only necessary working capital added, they could have earned good dividends and provided splendid service at comparatively low rates. But, being greedy, they have placed their capitalization at a figure representing many times the value of their tangible assets, and by so fixing rates as to produce dividends on this artificial capitalization have burdened the public and filled the heart of the average citizen with hatred for all public utility corporations. These "barons" at present view the situation with much complacency, feeling that if they are to be succeeded by enterprises operated by the municipalities it will be only after they have been paid for their properties at a

price representing the securities they have floated, plus a bonus.

They may be treated as they expect, but there is a legal question that suggests itself, which, when thrashed out in the court of last resort, may substantially disappoint them.

This question is: "In a contest between a municipality and a corporation operating under a municipal franchise, can the corporation be heard to claim a value in such franchise greater than the consideration paid therefor to the municipality?"

The subject of Municipal Ownership of Public Utilities, which is just now receiving so much attention from those interested in municipal affairs, is one that should prove of deep interest to the professional accountant. It will be practically impossible for municipalities to successfully inaugurate and conduct the business of street lighting or passenger transportation without enlisting the services of public accountants, at least in an advisory capacity. This being the case, the members of the profession should give the matter attention at its inception, in order that the best service possible may be given when the call comes. The municipal ownership movement will not stop until it has had a trial in almost every city of this country, and may extend even to governmental control of the telegraph, telephone and railway business. Already there is evidence that one of the great political parties will attempt to make government ownership of interstate utilities the issue of the next presidential campaign, with a better prospect of success than has attended some of the issues heretofore raised by the same party. Our advice to accountants is to make a special study of these lines of industry and be prepared for some of the best business that is to fall to the lot of the accounting profession.

**Causes
of the
Movement.**

**Some New
Business.**

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No. 3.

WATERED STOCK

BY CHAS. N. VOLLUM, C. P. A.

Some months ago, about the time of the formation of your Class, a communication was addressed to me by Dr. Meade asking if I would give a lecture before you, sometime during the winter, and suggesting that the subject be "Watered Stock."

The reason given by Dr. Meade for my selection to address you on this subject, "that he understood that I knew a great deal about that subject"—I hardly know whether to take as a compliment or the reverse, it depends entirely upon the viewpoint. I would only say, however, that in the many corporations I have been connected with, that whatever water there may have been, it was pure, wholesome water, that benefits one financially, as does pure, wholesome water benefit one physically, and that no undertakings born of hot air, and ending in a slaughter of the innocents ever passed through our office.

BUT TO COME TO THE SUBJECT—"WATERED STOCK."

What is Watered Stock?

You all know that the term "Watered Stock" is of very recent origin, and when used, it is intended to cast odium on a corporation. Under the old business dispensation, before "Higher Finance" became a science, it was customary for business men in forming a corporation to put up their hard cash in payment for stock, and the cash so paid was invested in the business, and if the company was successful and dividends

were earned, they reaped the benefits in dividends—but if they were not earned there were no fixed charges in the form of interest on bonds that must be paid.

Under the present system of finance, the actual or anticipated *earnings* of a company form in a great measure the basis of capitalization, and the bondholders and preferred stockholders are the actual owners of the company, with a guaranteed interest on their investment which becomes a fixed charge against the earnings, and the stockholders become the managers of the company, and their object is to make their stock, which in most cases was their fee for organizing the company, valuable, either, as in the case of legitimate businesses, by increasing the earnings over and above the fixed charges, so that dividends on stock may be declared—or in some other companies, of which we have had evidence in the past year, to so manipulate the stock through the stock exchanges that they become tempting bait for speculators and stock gamblers.

The following definitions of "Watered Stock" have been given me by some well-known financial, business and legal men, and I take pleasure in placing them before you for your consideration:

A prominent banker calls it "The stock-broker's football."

A prominent corporation lawyer calls it "The substance of things hoped for, and the evidence of things not seen."

Another prominent corporation lawyer calls it "The kind of stock a woman wants her broker to pay her for when she losses money on it."

A prominent promoter of good combinations calls it: "That which evidences the right of participation in future profits *if made.*"

Other parties will tell you that watered stock is overcapitalization, which may be a fact at one time, and not a fact at a later period of corporate existence, and is susceptible of many meanings.

Another will tell you that all stock issued over and above the intrinsic value of a concern is watered stock.

The last definition, probably, to the general mind, is the most favored one, as it seems to bear on its face the *dollar for dollar trade-mark*, forgetting that intrinsic value of to-day may be scrap value of to-morrow, so fast do processes and valuations change.

For the purpose of a better understanding of the subject, we will form a corporation and purchase a going corporation creating a capital stock that seemingly does not represent any actual, tangible asset.

A going corporation organized, say thirty years ago, with a capital stock of \$100,000 and a bond issue of \$100,000 is in the market for sale.

The whole of the proceeds of sale of stock and bonds at par had been used in building a plant, and the dividends declared by the corporation averaged five per cent per annum legitimately earned, after providing for all customary depreciation, the business, however, being *stationary*, neither *increasing* nor *decreasing*.

The stock of the company was offered at \$100 per share.

An examination of the earnings was made by an Accountant, and the physical condition was examined by an Engineer, whose report also covered the possibilities both of an increase in business by up-to-

date methods, and a decrease in expenses by the use of up-to-date appliances.

It was determined to purchase the stock at the figure named, and underwrite the bonds of a new corporation to be formed.

THE FOLLOWING IS THE MANNER IN WHICH IT WAS DONE.

The new corporation was formed with a capital stock of \$500,000 and a bond issue of \$500,000.

A sufficient number of the Bonds of the new Company were taken up by the Syndicate to pay for the stock—and \$100,000 in bonds set aside in hands of trustees to cover the outlying bonds of the old company, and \$250,000 bonds remained in the treasury for future sale for betterments to the old plant, and \$50,000 in bonds was given the syndicate, who also received all the stock of the new company, together with the \$50,000 in bonds, as a bonus for promoting the sale.

NOW LET US LOOK AT THE SITUATION.

The plant of the Old Company represented a valuation of \$200,000, upon which the dividend and Bond Interest amounted to \$10,000 yearly—the *New Company* had fixed yearly charges on \$250,000 in bonds issued, of \$12,500—an increase of \$2,500 per year—while the Stock was absolutely of no value until the earnings of the Company reached a point that dividends were actually earned over and above the fixed charges.

The next move was to sell Treasury Bonds and put in up-to-date machinery and appliances.

This required an outlay of \$150,000 and increased the fixed charges to \$20,000 per year.

Now let us look at the Plant and Franchise and Good-will account of the new company made up as follows:

Capital stock	\$500,000
Bonds issued	400,000
	<hr/>
	\$900,000

And what are the facts of the case as to the value of the Plant?

The old Company's Plant cost.\$200,000
The improvement made by the
new Company amounted to..... 150,000

Making a total value of.....\$350,000

But we must not forget a very important deduction from this value, if we insist on our intrinsic value view, and that is that, say, \$100,000 of the old Plant has been thrown into the scrap heap, and the intrinsic *i. e.*, that which cost a dollar is worth a dollar—is really but \$250,000 and is carried on three books of the Company at \$900,000.

And if we stop right here we have a most beautiful case of water—whole oceans of it.

BUT LET US GO A LITTLE FURTHER

The first year's business of the new Company during its improvements does not show the results from the improvements in increased earnings, and there is a hard time to pay that \$10,000 extra of fixed charges that we have placed on it, and it may be that the following year is not up to our expectations, but the company then commences to reap the benefit of its outlay.

By economical management, backed by improved plant, we find that the earnings are \$25,000 instead of \$10,000, and we have a surplus of \$5,000 that is applicable to dividends.

At the end of say, five years, the business shows a profit over and above fixed charges of say \$15,000, from which a dividend can readily be declared on the whole of the capital stock of the Company, which cost nothing, nor is represented by any so-called intrinsic value, but which is popularly called "Watered Stock."

I would say here that the example quoted is not a fanciful one, but its prototype has come under my observation many times during the past ten years, both in the purchase of old Companies, and combinations of competing Companies, and I would

also say that the cases in which the Stock of this kind of a Company comes upon the Stock market are very rare—the Stock being retained by the original promoters, who control and manage the company, and see to it that the best results are obtained, they being the most interested parties.

In other words such transactions are good, fair, business propositions, and while in some cases the outcome is not as large as I have stated, in others it far exceeds it.

We see the counterpart of this transaction in everyday business life.

A man thoroughly in touch with a certain kind of business, so impresses a capitalist that he is willing to advance money to start the business, under an agreement that he, the working partner, shall manage the business on a nominal salary, and that after paying interest on the capital, the working partner shall have a certain percentage of the profits, if earned, in a business to which he has contributed nothing.

The difference between these two ways of doing business is that in a Corporation the Manager or Promoter, whichever term you may select, secures his interest by the issuance to him of certain Shares of Stock, which "are evidences of his right of participation in profits when earned," while the working Partner secures his interest in the "profits when earned," by a partnership agreement.

The advantage that the holder of the Stock Certificate has, is, that the evidence of his interest is divided into such portions as he may see fit, and if he can imbue others with his faith in the success of his undertaking, he may sell certain portions of his holdings, while the business Manager or Promoter in the other example has no evidence of his holdings except in the Partnership papers which are not negotiable.

There is no doubt that a Promoter's faith in his judgment may lead him astray, and results may not prove as he anticipates, both in Corporation and Unincorporated business

ventures, but in cases like the Corporation mentioned above, there is a very small percentage of the failures that the Assets do not realize enough to pay the Bondholders, the true Owners of the Corporation.

In the case of the original formation of the Copper Corporation as stated by Mr. Lawson, we find that his intention was the combination of certain Companies that were earning a profit of from twenty per cent to twenty-five per cent to their owners, and forming a new Corporation that would pay five per cent to the Investors.

If a combination could be made of all the Copper interests whereby a dividend of say five per cent could be assured to the Investors, judging from the earnings of the separate Companies, the proposition as a business proposition was a good one, and whatever Lawson, Rogers or any of the other brainy men, who dared risk their time and money in such an undertaking, made out of it, is a matter in which the public has absolutely no concern.

It must be understood, however, that the above remarks apply only to the business aspect of the proposition, namely, that a corporation formed on a basis of earnings of five per cent on the investment is a legitimate, good business proposition.

If, however, any part of the businesses upon which this proposition and agreement was made was not turned over to the new Corporation, it will be readily seen that fraud has been perpetrated.

The fact that the Stock of this Corporation became "a football for Stock Brokers" and a battle ground for money giants, and that the Public lost money in the rise and fall, has no bearing on the question as to whether the original proposition, carried out in good faith, was a good business venture.

You must not forget that business risks are the same whether you are trading as an individual, in partnership, or as a Stockholder of a Corporation, and that the same

care, and in fact more care, should be exercised by you in buying Stock or Bonds of a corporation than you would in buying any article of merchandise.

Now let me cite you another case that seemingly is promoted under the old system, and that is the sale of Stock for Cash.

A Company is formed to develop mines, industries, patents, etc.

The Promoters spend money freely in advertising the merits of their projects and the public are dazzled with the sudden wealth that seems to be thrust upon them, merely for the investment, by them, of a few dollars. They hustle and crowd each other in their fight to be among the first to the slaughter pen.

Their days and nights are filled with dreams of the wealth that is *almost* in sight.

The Promoters, however, are the only ones to chuckle and feel good in this kind of Corporation.

The victims pay with their hard cash for the flaming advertisements, the superbly furnished offices, the high-priced lawyers and other incidental expenses popularly denominated Organization Expenses, while the Promoters, who have probably taken the lion's share of the Capital Stock, keep on feeding it through the Stock Exchanges to the eager gamblers, who, when the bubble bursts, are not like the genuine gambler who takes his medicine in silence, but play the baby act—howling for sympathy—calling the originators swindlers—and all the vile names possible—demanding their punishment—forgetting that their own eagerness to make a dollar where they did not earn it—forgetting that their own desire to reap where they had not sown—forgetting that the want of even very ordinary prudence on their part were the causes of their loss.

It is said that a new crop of fools is born every day, and there certainly must have been a very large crop on hand judging from the disclosures of the last few years.

The Stock of this kind of Corporation, it would seem, should be called Watered Stock, if by the term Watered Stock we mean to convey the impression of a swindle.

The people who invest in this class of Stock for Income are few, and those that do so should have clear-headed guardians appointed to take care of their interests, and invest their savings in solid, safe enterprises, which are not hard to find.

For the other class, the gamblers, the would-be quick-rich people, that make such Corporations possible—no sympathy should be extended, as it is not deserved, and no *publicity, nor legislation*, will protect them, nor prevent them doing the same thing over again whenever opportunity occurs, for unfortunately gambling is inherent in humanity, and the effort to get something for nothing is going on all the time, and the consequences to the “other fellow” are never taken into consideration.

Brains, whether used for honest or dishonest purposes, command respect, and the multitude follow, in some cases to their making, in others to their disaster.

It must not be understood that all mining, patent and similar corporations are in this class.

There are companies formed for development of mines and ideas and enterprises in which no element of fraud exists, but the results are based on faith, which might on a free interpretation be called discounting the future, yet human nature is so constituted that if the future fails to reach our expectations, we are apt to forget our first impressions when we made our investment, and try to find some other fellow to blame for our loss.

We have now before us two types of corporations, which may come under the charge of issuing Watered Stock, as that term is popularly understood, that is, having no tangible asset to account for its issuance.

I would merely say here that the first

example may be extended to represent millions or billions of Common and Preferred Stock and Bond issues covering the purchase of one Company, or combinations of many companies with corresponding profits to the Organizers.

Now let us look at the results to the public—treating the last class as being no more worthy of discussion than any other swindle that men endowed with ordinary common sense avoid.

There are four questions that seem naturally to present themselves in regard to the first example:

First.—Has value been given for issuance of unpaid-for Stock to Organizers, and is a statement issued by such Corporation covering such issue into Plant and Franchise, etc., *misleading and incorrect*?

Second.—Is the system of organizing a Corporation with a Capital based on the *earning capacity* a good business proposition?

Third.—To what extent is the public interested in such matters?

Fourth.—What safeguards should be provided by legislation to protect Stockholders of Corporations?

i. Has value been given for issuance of unpaid-for Stock to Organizers, and is a statement issued by such Corporation covering such issue into Plant, Franchise, etc., *misleading and incorrect*?

Before we answer the question “has value been given for the issuance of unpaid-for Stock to Organizers,” it might be well to ask, What has the Organizer received as compensation for the successful formation of a Corporation?

It can only be answered that he has received a beautifully engraved Certificate stating that he is the owner of so many Shares of the Capital Stock of such a Company, of no value to him, unless he can make it of value by further hard work, or in other words: “It is the evidence of his

right to participate in future profits 'when earned.'

It must be granted that, in many cases, the Organizer is enabled by the method termed "washing" in the Stock Exchange or by other methods, to have a value placed on the Stock and get the cash for it—but *the purchaser takes the risk of the future in place of the original owner*, and displays great faith, to speak conservatively.

But, "has value been given for issuance of this stock "

I think there will be no hesitancy in saying yes to this question, and more than value—if the Organizers' brains are worth anything. The Organizer gets a piece of paper of no value unless his further efforts make of it value—while the Corporation *parts with no valuable consideration in parting with that paper neither does it put in jeopardy the interests of its creditors, nor its Preferred Stock or Bondholders*, while the purchaser of such Stock is entitled to very little consideration from the standpoint of business.

The view taken here as to the value of such Stock is fully confirmed by the statement, that among financial backers of such enterprises millions of dollars of such Stock are carried on their books at a valuation of one dollar.

Now, as to the question is it misleading or incorrect to cover such issue into Plant, Franchise, etc., or any other term covering the general Capital Account.

On the principle that a thing is worth what it costs you, there can be but one answer to this question, and that is, yes, the books of the Corporation must show the purchase price whether in Stock or dollars and cents.

The question as to "misleading" requires a more extended answer. Who does it mislead? Certainly not the original Stock or Bondholders, for they were in at the birth of the Company.

Certainly not the public who are not in-

terested in the Corporation and do not buy the Stock or Bonds.

There can then be only one class of people to "mislead"—the would-be Investors or Purchasers.

These consist of two classes:

Investors for Income results.

Purchasers for a gamble.

Investors for Income can at any time ascertain the true condition of a Corporation—and let me say here, the question as to whether a Corporation has a million or ten million dollars capital, or how it is invested, very rarely enters into their calculations, the main inquiry being, "What are the earnings of a Company above its fixed charges, and are they large enough to assure me a settled income?"

The investor then certainly is not misled by the Capital Account.

Now as to the purchaser for a gamble—he is unique. It does not make any difference to him whether the Company is called "Rapid Transit to the Moon," "Subterranean Express to China," "Perpetual Motion Co." or the "Pennsylvania Railroad Co."—all coons are alike to him.

He watches the ticker—"Rapid Transit to the Moon" has gone up one point, and some crony of the same type and caliber gives him a tip—that it is on the rise—he rushes to his broker, invests a few dollars—may make a few more, at last loses all the little he has, and cannot tell the next day what stock he purchased, but he *is absolutely sure it must be a swindle*, and the rogues at the head of it ought to be in prison—although it might be that the company was first-class, and he had gotten into a temporary stock scrimmage in which he had no right to be mixed.

It is very certain that the "purchaser for a gamble" is not misled, no matter what you may publish as to the capitalization of a company.

The Stock Exchange manipulations can hardly be called purchases—for although

the Stock Exchange rules are very strict as to "washing," that is, selling and buying stock for one owner without any *bona fide* purchasers—yet such things may be done without the knowledge of the governors of the exchange, and even were they not done, the fight for control between the money giants very often raises and lowers the price of stock whether the stock represents organizers' bonus or not, or whether any returns in the form of dividends will ever be made, and when these fights occur, the *dear public* think that they can gather some crumbs from under the rich man's table, and take a hand in the fight, and then wonder what was in those crumbs to give them such a bad case of financial indigestion.

ALL BUSINESS IS MORE OR LESS A MATTER OF FAITH IN THE FUTURE.

A man invests \$100,000 in a mercantile business without any guarantee that the results of his business will pay him a good income for his services and capital, in spite of the well-known fact that about ninety per cent of business men fail in their efforts.

The organizer,—understand, I am talking about the honest one—has faith that if certain conditions can be secured, certain good results can be attained—he favorably impresses financial men with the same views, and capital is forthcoming and the company is started.

The work of the organizer then commences in getting the best management possible to carry on the operations of his company.

If success attends his efforts, he reaps the benefit, if failure, the odium—and if he is parted with some or all of his stock, without misrepresentation, even if the company has paid good dividends for a number of years, there is a hue and cry of fraud—watered stock, etc., that the intrinsic value of the assets of the company were almost nothing, as compared with the amount carried as plant, franchises, etc., on their books.

At this point it might be as well to say a few words about "intrinsic value."

What is it and what part does it play in settlement of the claims of creditors?

In mercantile business a bale of goods costing \$100 can usually be counted upon to realize from sixty per cent to seventy-five per cent of its cost at a forced sale—the same probably is true as to raw material in a manufactory—but when we come to machinery in a manufacturing establishment, how much above scrap iron prices does it realize?

In a trolley line, you do not sell the rails or cars to satisfy a claim. The value of a rail taken from a road is nothing but scrap prices—the value of a car at second hand represents very little of its first cost.

All matters of this kind must be taken at a valuation of a going business, and not as to its value in case of a failure, or to be used as an asset to be realized upon to pay creditors.

The plain, practical, common-sense view to take as to capitalization is not that the assets owned by a company in a going business could possibly, by forced or even an amicable sale, realize enough to pay the stock and bondholders dollar for dollar for their investments, unless the company is sold as a whole, and the value of a company as a whole does not altogether consist in how many dollars' worth of machinery, real estate, etc., there may be owned by it, but what can be *earned* by these appliances in their *particular environment*.

What is the franchise, the good-will worth? On what amount of capitalization can a *fair interest* be made?

Men differ in their judgment as to these matters, as they differ in every other business transaction.

John Jones thinks by certain changes in the operations of a company he can afford to buy a concern at \$100,000 more than it seems that the old concern is worth, and has the courage of his convictions and buys

it. He does not stop to consider the value of each piece of machinery, each piece of real estate.

He wants only to know the *earning capacity* under present conditions, and has faith in his own judgment as to future results.

Take a public utility company, say an electric company, as being the best example of intrinsic or no intrinsic value.

One year ago a plant is erected that cost \$100,000, and to-day we find a new invention that has made our plant a back number, and we have to get into the swim and put in the new invention if we want to keep in touch with our competitors.

This means that \$100,000 of our investment is gone and we put another \$100,000 in—and now have an investment of \$200,000 and have an intrinsic value of \$100,000 for how long?

To be sure we can reduce this \$200,000

by a depreciation account drawn from profit and loss, but the fact still remains that “intrinsic value” is a matter of a day or a month or a year, and has no bearing on the value of a business, and that no company engaged in any kind of business could by the simple process of liquidation realize enough from its assets by a piece-meal sale to pay their investors.

The term intrinsic value is a sadly abused one in all our walks of life—it is as deceptive as measuring distance from the mountain top.

We buy a piano for \$1,000—it is put into a wagon and is our property—to-morrow we try to sell it—we can get but \$500.

The intrinsic value has disappeared.

We buy a watch, household furniture, anything; we endeavor to sell, the value disappears.

(To be continued.)

BANK DEFALCATIONS

BY SEYMOUR WALTON, C. P. A.

It would seem that the banks of the country should adopt some plan that would tend to lessen the large number of defalcations that have recently been discovered. Every accountant knows that many of the shortages that occur in banks, as well as in ordinary commercial houses, are never made public. Not long ago there was a very large shortage in a bank which was not made known even to the board of directors, for fear that a disastrous run would follow. Although the defaulter was bonded by a surety company no attempt was made to collect on the bond, because the officers were of the opinion that the amount that could be thus recovered was too small in comparison with the total shortage to make it worth while to collect it and then to face the inevitable run.

In addition to the cases where the short-

age is discovered but not made public, there may be an unknown number of instances in which the shortage is temporary only. When the money has been used in speculation there is a chance that the market may turn in favor of the defaulter and he may be able to replace the money he has taken without anyone being the wiser.

In view of the large number of such cases that have become known and of the unknown number that may exist, the officers of the banks owe to their stockholders and depositors the duty of adopting some plan that will make such defalcations more difficult, and if possible prevent them altogether. The trouble with the situation is not that it is impossible, or even difficult, to devise a feasible plan, but that the banks do not seem to appreciate the advantage of this kind of protection. At least this

would seem to be the case, judging from my own experience with our principal Chicago banks.

Some years ago, after a remarkable defalcation by an officer of a large local bank, I visited the officers of similar institutions and laid before them a plan by which the covering up of a shortage in the out-of-town accounts could be absolutely prevented by the employment of public accountants. The history of all large defalcations has been that wrong entries have almost always been in that class of accounts, because they were the least easy to check. Not a single banker could object to the details of the plan nor deny that it would effect its object, and the expense was so small in comparison with the insurance obtained that it was not even discussed. One man said that if he had to watch his men like that he would go out of business, which he has since done. Another, that he might be foolishly confident, but that he knew all his men were absolutely reliable. It has since cost his bank a good many thousand dollars to find out

that he was wrong. Others made similar excuses for themselves, but thought the plan an excellent one for everyone else. The crowning interview of all was with the active officer of one of the largest banks, who was very much interested in the idea and commended it warmly, but did not think his bank needed it. It must have been a grim jest to him to thus ward off an investigation that would have exposed the largest defalcation this city has ever known, which resulted in the failure of the bank and suicide of the officer in question.

The official bank examiners are not to blame for not discovering these discrepancies. They have not the time to do it, and it is not strictly any part of their duty. They are more concerned with technical violations of the banking laws. The directors are supposed to see that the interior machinery of the bank is working correctly and since they have usually neither the time nor the ability properly to oversee its operation, they should employ outside expert assistance, as the Comptroller of the Currency has advised them to do.

APPRAISEMENTS AND ACCOUNTANCY

BY FREDERICK A. CLEVELAND, PH.D.

(Concluded from April issue.)

THE APPRAISEMENT OF PROPERTY OF A CONCERN IN LIQUIDATION.

As to the property of the concern in process of liquidation, salability or convertibility into cash is again the governing principle. A different condition, however, prevails than with the current assets of a going concern. Sale or conversion is not to be made in the regular course of business since the business as such has ceased. If conversion is to be made under circumstances of a forced liquidation, then auction process in a poor market may prevail. If it be a

case of voluntary liquidation, the appraiser must consider the time which may be given to buyers as well as the better opportunity which may be had to find purchasers at a higher price.

Similar considerations also cause an investor to make a special appraisalment of value of a property or estate offered or held under contracts of lien as security for the payment of a note or bond issue. An expert appraiser may, by conservative judgment, arrive at a conclusion as to the value of assets for the purposes of a going concern, which is far different, perhaps twice

the amount, which the same appraiser would arrive at in the valuation of the same assets for purposes of security. The contract of security is one permitting the creditor to realize by process of forced liquidation. While the property, therefore, is that of a going concern, the appraisement is made on the assumption of winding up, and the trustworthiness of the judgment of the appraiser for purposes of investment must be judged accordingly.

APPRAISEMENT, OR ASSESSMENT FOR PURPOSES OF TAXATION.

The accountant at times may be called on to exercise judgment or render professional opinion as to the appraisement of property for purposes of taxation. Except in contested income tax cases, this has heretofore been considered entirely outside of his sphere. But even for the purposes of a general property tax (where any matter of accounting result is used as a basis for the judgment or estimate of value) the public accountant may be brought in, not for the purpose of making the appraisement (the public appraisers or assessors are appointed for this), but to give professional opinion and advice to the board of equalization as to whether the appraisement has been properly made. In such circumstances, however, the governing principle or the standard which is to be used to measure the judgment of the assessors must be a quite different one from the one employed as a basis for critical review of the valuation of properties for any business purpose. The business purpose which determines the appraisement of value of the capital assets of a going concern is one of protection of capital against impairment and of arriving at a proper basis for the estimate of profits. The business purpose governing the appraisement of the current assets of a going concern is to determine the present and prospective avails of these assets in current funds or cash for current use. The business purpose of appraisement of the assets

of a concern which is winding up its affairs is judgment as to controvertibility or availability of the entire property or estate for meeting outstanding liabilities in final distribution. The purpose of appraisement (assessment) of value of property as a basis for taxation is to arrive at a fair and equitable apportionment of the tax burden. Equity between property holders to be determined from the point of view of ability to pay is the theory on which a property tax is levied. The assessor is to make an appraisement of value with this end in view.

Regarding the equity of a tax apportionment as the determining factor in appraisement, the judgment of the appraiser must be governed by the theory of equitable distribution under which he is to act. If it be assumed that the tax burden is to be borne by the various members of the community according to their ability to pay them, since a tax is a current expense and the ability of an individual to pay current expenses depends on income, the assessment or appraisement of value of properties places a property tax on the same basis as an income tax. The conclusion may be accepted as true, with this qualification, that the total property valuation which is to be used as a common denominator in the apportionment should include not only a valuation of properties in operation, appraised with respect to actual incomes, but also properties not in operation appraised with respect to prospective or probable incomes. In arriving at "means" as a just basis for apportionment of a tax burden, the board of apportionment or tax equalization may find it necessary to call in the services of a public accountant to find out what the true incomes of companies or concerns are, in order that the tax assessment may be fairly judged. This is especially true of large corporate concerns such as railways. Assuming that the equalization board were to take this view of the case, a proper distribution or apportionment of taxes would re-

quire that they ascertain through advice of accountants or otherwise whether or not the report of net income or net profits as shown by the company or reported to them is a character of statement that might be used as a basis for official action. To this end inquiry should be made as to whether the company had charged too little or too much to the several expense accounts, whether too little or too much had been allowed for depreciation, whether a part of the income of the road had been hidden in betterments, whether a part of the receipts from sales of credit or of capital resources of the company had been included in net income, whether the capital of the company had been impaired by distribution in dividends, etc.

Whatever may be the method of determining whether or not the assessment had been properly made, the conclusion would seem to be beyond question that an assessment or appraisal as a basis for the equitable apportionment of taxes would rest on an entirely different basis than an assessment or appraisal for a private business use. For the same class or character of property and the same amounts in kind, therefore, at least four different conclusions might be reached, according to the purpose for which the estimate or valuation was to be made: (1) One conclusion might be arrived at if the property or estate were to be used as a capital resource of a going concern. (2) Another conclusion might be reached if it were appraised as a current asset of a going concern. (3) A third judgment might be quite as conservatively made if the property were the estate of a business in process of liquidation, or if the appraisal of value were to be based on the possibility of a bond issue. (4) A fourth value might be placed on it as a basis for taxation.

IMPORTANCE OF A KNOWLEDGE OF THE METHODS OF MAKING AN APPRAISEMENT.

Since the accountant is not an appraiser, a knowledge of the considerations which

should govern the appraiser's judgment can be useful only as a guide to a critical examination of his methods and results. To the appraiser he stands in the same relation as to the bookkeeper. He must know the methods of bookkeeping for three reasons: (1) The system of accounts devised and installed by the accountant must depend on the bookkeeper for their execution or administration; (2) as supervisor, the accountant must know how the books should be kept; (3) as auditor, he must take cognizance of the principles and methods employed in order to exercise critical judgment as to results obtained. In matters of appraisal he stands in much the same relation. While at no time in the practice of his profession may the public accountant be called upon to exercise judgment as to value, in devising system of accounts he may include in a system devised by him the method and manner in which appraisements of each class of assets shall be made, and to this end he may prescribe the form in which the appraiser's report shall be returned to the head bookkeeper; he may also supervise the taking of an inventory to see that the specifications are properly followed; again, he may audit or critically examine the result before attaching his certificate to the balance sheet, or to other financial reports and summaries of assets. For any of these purposes he should understand accredited methods and be able to reach a conclusion as to whether the particular method under review by him is one by means of which a fair judgment of value may be reached by an appraiser.

STATEMENTS OF VALUE DRAWN FROM RECORDS OF COST.

One of the common methods employed for stating the value of assets is to carry down the footings of the cost of properties. That is, the asset account is closed without any attempt being made to appraise present worth, either by calculation of depreciation or otherwise. While this is the method

most frequently used, it is obvious that in such a statement no attempt is made to arrive at present value. At the time property is purchased, it may be fairly assumed that in the mind of the proprietor or of his purchasing agent the property was worth the amount paid. Any other conclusion would be based on the opprobrious assumption that the one in charge is unfit to do business. Such an assumption should not be engaged either by the bookkeeper or by the accountant. But from this it does not follow that the transaction represents the judgment of the proprietor or of his purchasing agent ten days or even ten minutes later. A gold mine may have been purchased at a million dollars. The next day something may have developed which causes the proprietor to conclude that it is not worth more than a hundred thousand dollars. A factory site may have been purchased, and as one of the considerations in the estimate of value on the part of the purchaser an engineer's statement of water-power. A subsequent examination may show a mistake in figures which would cause the purchaser to conclude that his previous estimate had been too high. It very often happens that a purchaser is led to believe that he has paid too much for a property as soon as the deal is closed.

Even when cash is paid for a property the cost is no criterion for present worth. The most that can be said is that it indicates what, by the purchaser, was considered a conservative estimate of value at the time the purchase was made, and therefore may be taken into consideration. But when cash is not paid (and all statements of assets are reduced to a cash basis), when stock liabilities are exchanged therefor, or other properties so traded, the cost price as recorded in the book may give no guide to the judgment of the purchaser as to worth at the time of the transfer. To arrive at this, one must know what the purchaser considered the property or liability to be

worth which was given in exchange, and as to this there is no record. A statement drawn from the footings and balances of asset accounts is a bookkeeping summary without any attempt being made to determine present value, and unless the bookkeeper is employed or empowered to make an appraisement, he has nothing else to do. His duty it is to record transactions and to make entries in the book or books, for which he is held responsible, from data furnished. If he does this with integrity and shows the true book result of such entries this is all that can be expected.

APPRAISEMENTS MADE BY BOOKKEEPERS.

It sometimes happens that in a going concern a special bookkeeper or a head bookkeeper, a chief clerk or a company accounting officer is called on to make an appraisement. The most frequent use of the bookkeeper or clerk in this capacity is to "take stock." Where this method is pursued, inquiry should be made both as to the method and as to the competence of the one on whose judgment the statement is based. In any case, the appraisement seldom goes further than the "stock" in trade. Even if it includes all of the "current assets," still the "capital assets" are unappraised. But as to the assets represented, the reliability of the report or estimate as a basis for account is open to investigation. Was an inventory taken? If so, was there an actual count? If an actual count were made, was care taken to include damaged or shopworn goods? What was the basis for the estimate of value of the "active" stock, and what was the basis for the "dead" stock? This being determined, question may come up as to the qualifications of the one whose judgment was recorded. Was he familiar with the stock? Did he know the market? Had he sufficient knowledge of the business to know what might have been expected in the regular course of trade? All of these and other questions might be raised in de-

termining his competence to make a trustworthy judgment as to value.

THE USE OF DEPRECIATION TABLES AND SIMILAR DEVICES FOR DETERMINING
PRESENT VALUE.

Where any attempt is made to arrive at present value, direct appraisalment and inventory record is most frequently used with reference to current assets. In getting at the value of the more permanent or longer-lived capital assets, however, resort is often had to what is known as depreciation tables. Instead of having a review and inspection of the premises, an effort is made to devise a table based on business experience by which the life of the asset may be determined, and a proportionate amount may be entered each year as depreciation. This is a method of arriving at the present value from previous cost or appraisalment through mathematical calculation. The purpose of appraisalment or of statement of value of capital assets being an administrative or proprietary one (i. e., one of protection of capital against impairment), this method has been found well adapted to the end or purpose of the capital accounts of a going concern, although it could not be used either for the statement of current assets nor for the statement of the assets of a concern winding up its business.

Generally speaking, there are two ways of accomplishing this result. The amount of the depreciation calculated may be written off against the property, or the estimated reduction may be set up as a surplus reserve. When the reserve method is employed, the handling here is dependent on the basis of the estimate as to the amount of depreciation. If, for example, it is estimated that a steel cable used in a power plant will last ten years without repair, then ten per cent of the cost of the cable would be charged each year against current income, and any repairs that were made would be entered as a charge against the

reserve. Again, if it is estimated that the cable would last twenty years by keeping up current repairs, a depreciation reserve of one-twentieth the cost of the cable would be set up and entered as a current expense in addition to repairs made.

In any case, however, a depreciation table is nothing but a forecast of the probable wasting of a property or an asset. The table itself is a record of a judgment made in advance, which the bookkeeper in a clerical way applies to the account to be handled. This judgment may be found to be erroneous; it may not be borne out by experience. The accountant should therefore inquire both as to the premises or foundation for the initial judgment in accordance with which the table was compiled and as to whether, as far as possible, this result is checked by current experience. The depreciation tables originally used may have been revised; actual appraisalment of the property may show that the wasting of the particular properties under consideration did not follow the general experience, in which case the record must necessarily be corrected.

THE APPOINTMENT OF EXPERT APPRAISERS
AS A MEANS OF DETERMINING
VALUE.

Of all the methods used as a basis of recording present worth the appointment of expert appraisers would seem to commend itself most favorably to the accountant. Even for determining the value of such capital assets as buildings and other permanent improvements where depreciation tables have been worked out and fairly established in general experience, it would seem that an occasional expert appraisalment would commend itself. It has already been suggested that the value of an inventory of "stock" depends largely upon the experience of the stock-taker. Where appraisements are made of other classes of property, the same inquiry is pertinent.

Especially is this true of estates and classes of equipments where technical knowledge becomes necessary to a trustworthy judgment. An estimate as to the value of a steamboat, which may be accepted and considered an authentic document for the purpose of accounting, must come from an expert steamboat appraiser. To be qualified as such it may be necessary for him to have a technical knowledge of all the details not only of steamboat building but of steamboat navigation. A trustworthy appraiser of real estate must have knowledge of the value of building locations and other conditions affecting the real estate market, as well as the prices current in different localities. To estimate whether proper allowances have been made for depreciation in railway properties, the appraiser must necessarily have, not only a knowledge of the mechanical and engineering side of railway construction and operation, but must also know something of the character of use to which the property is to be subjected in the business requirements of the road.

Generally speaking, the accountant

passes on the work of the appraiser much as a court passes on a case before it which involves inquiry into the conduct of an officer whose duty it is to exercise discretionary power. In devising a system of accounts he may lay down the rules governing the exercise of discretion and indicating the subjects to which the rules apply. As a supervisor of the system installed he may compel the exercise of discretion by an appraiser though he cannot influence the judgment as to value which is reached by him. As auditor, his duty it is to critically examine the result and determine whether the judgment of the appraiser should be allowed to stand as the basis for bookkeeping entries in asset accounts and in summaries of asset accounts. In the exercise of this function the accountant should inquire with respect to the purposes of the appraisal, the personal qualifications of the appraiser, and the method employed by him in arriving at his conclusion. This done, the accountant may then render professional opinion as to the truth or falsity of statements of present worth and present financial condition.

SOME SPECIAL POINTS IN ACCOUNTANCY PRACTICE

BEING A LECTURE GIVEN ON MARCH 8 BEFORE THE SCHOOL OF COMMERCE, ACCOUNTS AND FINANCE, NEW YORK UNIVERSITY

BY ARTHUR LOWES DICKINSON, M. A., F. C. A., C. P. A.

(Concluded from April issue.)

In fact, at the present time provisions for accrued renewals are to a large extent guesses, though it may be said that in most really sound undertakings the guesses appear to be on the safe side. In due course, with less prosperous times, the provisions are likely to be reduced and the guesses may well be on the wrong side.

The whole history of this question in America shows a swing of the pendulum

between the two extremes of providing insufficiently, so unduly increasing earnings, and providing so liberally that actual additions to property have been known to be charged to expenses of operation, thus unduly depreciating both earnings and stock values. It is here that the inculcation of sound accounting principles can be of value to investors, not necessarily in changing a practice which may in both extremes be entirely right and proper, but in showing on the face of the published records ex-

actly what provision has been made and the basis on which it rests.

CONSOLIDATED BALANCE SHEETS AND EARNINGS ACCOUNTS.

Perhaps one of the most important developments of accounting practice in the last few years has been due to the growing tendency to form large aggregations of capital on the basis of a control by one corporation of the whole or the majority of the stocks of a number of others. It has generally been considered that the balance sheet of any corporation, prepared from books and records properly kept, would disclose its true financial position, but the development of this system of control has shown that such a balance sheet will no longer suffice for this purpose. It is important to realize the difference between an investment in a company representing only a small proportion of its capital stock, and an investment representing the whole or practically the whole, and carrying with it the absolute control of the operations. Thus corporation "A" may own the whole stock of corporation "B," both carrying on a similar business. Stockholders in "A" may know this fact, but have no means of ascertaining the real position of corporation "B." "A" having the control of "B," may turn over to "B" all its unremunerative work, with a result of showing large profits on its own accounts, while the accounts of "B" show correspondingly large losses. Corporation "A" in its balance sheet carries its investments at cost, probably merged under the general head of "Cost of Properties," with all its other capital assets. Corporation "B" may incur loans from corporation "A" which largely exceed its current assets, and may have been expended in construction work, or even lost in operations, while corporation "A" carries in its balance sheet these same loans as current assets recoverable on demand. It is only

necessary to point out that many of the railroad receiverships twelve years ago arose out of a state of affairs very similar to that described, to show that this is not an imaginary condition. Realizing the misleading character of the ordinary balance sheet in such cases, the public accountant has evolved the consolidated balance sheet, the basis of which is the recognition of the common sense fact that a network of companies connected with each other by control of stockholdings is still in effect one undertaking, and that if the stockholders in the holding company are to have before them a clear statement of its position, the legal technicalities between the different companies must be brushed on one side, and the position of the holding company shown in its relation, not to these sub-companies, but to the general public. To give a pictorial illustration of this position, imagine a large sphere containing a number of smaller ones. No change in size or position of the smaller spheres which arises inside the larger one can in any way effect the latter, in which in turn no change can take place except by the entry of something from outside, or the abstraction of something from inside. Thus the whole position can only be changed by outside influences and not by any relative changes of its component parts. The consolidation balance sheet represents the true position of the whole group of spheres to the outside world, and is thus not the balance sheet of a corporation, but of a condition after eliminating all the relations of the spheres one to another—debts due by one company of the group to another, stocks of one company owned by another, earnings of one company owned by another, are all eliminated. The amount by which the value of the stocks of any company on the books of another exceeds or falls short of the par value thereof, represents an addition to a diminution of the asset of good-

will in the final balance sheet, and as a result the capital assets in the consolidated balance sheet consist of the total physical assets of all the companies, that is, land, buildings, plant, machinery, etc., and in addition an item of good-will represented by

(a) The good-will asset in the balance sheets of the subsidiary companies, and

(b) The amount by which the book value of the stocks of one company held by another exceeds or falls short of the par value of that stock.

Similarly, the capital liabilities represent the stocks and bonds of all the companies in the hands of the public, those owned between companies being eliminated.

The consolidated earnings account should be made up on the same principles. Profits resulting to one company out of sales to another should be eliminated. Only sales and purchases to and from the outside public should be included, so that no profits are considered such except on deliveries outside the organization.

In other words, the whole organization is considered as merely a series of separate works under the same ownership, and the same accounting principles which would apply to a corporation owning one small factory are applied to the large corporation owning the whole stocks of a number of subsidiary companies, which in turn own the stocks of other subsidiary companies, all the companies in the group themselves owning and operating their own factories. It will readily be supposed that in practice the preparation of a statement of earnings exactly on the basis here laid down is a difficult matter, and probably in all its elements has never yet been attempted, but inasmuch as a neglect of these principles, so far as the profit and loss account is concerned, only means the swelling of the totals both of gross earnings and cost of operation, it is not of so much importance, provided that the valuation of the stocks

of goods on hand is made on the basis of actual labor, material and expense involved therein, without any proportion of the profit of the different companies in the organization through which these profits may have come.

A balance sheet of a corporation, whose only assets are stated to be investments in other companies, should be looked upon with suspicion, unless the names of the other companies are given, and clear statements are also given of their financial position, but such a collection of balance sheets cannot show the true financial position of the whole group until they are all collected into one and the inter-company interests eliminated.

CONCLUSION.

In the above sketches an attempt has been made to call your attention in a general way to the nature of some of the more important questions with which the accountant has to deal. Every one of the matters mentioned is of frequent occurrence in practice, and many more ingenious arguments than can be mentioned in the limits of a lecture are continually brought forward in the support of methods which are utterly unsound. The accountant requires to be a perfect master of his subject and to keep a cool head and an even temper in discussing such problems and endeavoring to upset the many false theories with which he is confronted. Unfortunately, in too many cases, the supineness or want of intelligence of the average investor is such that the accountant obtains little or no support in fighting the battles of the public, to whom it is frequently a matter of perfect indifference whether a balance sheet is certified or not, or whether, if certified, the certificate contains any important qualifications. But this condition of affairs is rapidly changing. The demand for an independent, unprejudiced and unbiased examination and report

upon the published accounts of corporations is increasing every day, and it is safe to predict that within a few years the cer-

tificate of a public accountant to corporation balance sheets will be universal in this country as it is to-day in Great Britain.

MISCELLANY

THE MICHIGAN LAW

We are indebted to Mr. D. W. Springer, chairman of the legislative committee of the Michigan Association, for a copy of the C. P. A. law enacted by the legislature, which was signed by the governor on May 4. We congratulate the profession in Michigan upon the success of their efforts in obtaining the passage of this bill.

"AN ACT

To establish a board of accountancy, to provide for the granting of certificates to those public accountants who qualify under the provisions of this act and to provide a penalty for violations thereof.

"The people of the state of Michigan enact:

"Section 1. Any person, residing or having a place for the regular transaction of business in the state of Michigan, being over the age of twenty-one years, of good moral character, who shall have received from the governor of the state of Michigan a certificate of his qualifications to practice as a public accountant, as hereinafter provided, shall be styled and known as a certified public accountant, and no other person shall assume such title or use the abbreviation C. P. A., or any other words, letters or figures to indicate that the person using the same is such certified public accountant.

"Section 2. Within thirty days after this act takes effect, the governor shall appoint three persons to constitute and serve as a board of accountancy. Two members of this board first appointed shall be selected by the governor from a list of names of public accountants who have been prac-

ticing in the state of Michigan for a period of at least three years, one of whom shall be appointed for a term ending January 1, 1908, and one for a term ending January 1, 1910, and upon the expiration of each of said terms and of each succeeding term, a member shall be appointed for a term of three years: Provided, that the successors of the first two members who are public accountants shall be selected from the holder of certificates under this act. One member of this board shall be a practicing attorney, in good standing in the courts of the state of Michigan, appointed in the first instance for a term ending January 1, 1909, and upon the expiration of said term, and of any succeeding term, a member shall be appointed for a term of three years, such successors to be practicing attorneys in good standing, as hereinbefore mentioned. Any vacancies that may occur from any cause shall be filled by the governor for the unexpired term under the same conditions that govern regular appointments.

"Section 3. The board of accountancy shall at its first meeting formulate rules for its own guidance, not inconsistent with the provisions of this act, a copy of which will be sent to all public accountants in the state. Satisfactory evidence of good moral character shall be required from each applicant for his certificate. Examinations of persons applying for certificates under this act shall be held at least twice each year at such time and places as applications may warrant. The time and place for holding the examination shall be duly advertised at least three consecutive days in a daily newspaper published in Detroit,

Grand Rapids, Saginaw, Marquette and Houghton at least thirty days prior to the date for such examinations, and notice of the same shall be mailed to all holders of certificates under this act, as well as applicants. The examination shall cover the following subjects: Theory of accounts, practical accounting, auditing and commercial laws as affecting accountancy. The fees for such examination shall be twenty-five dollars for each applicant, payable to the treasurer of the board at least ten days prior to the holding of the examination. The board may in its discretion waive the examination of any applicant not later than the year 1906, who in addition to the qualifications mention in section 1, shall have been a practicing public accountant in this state for more than one year prior to the passage of this act. Each applicant for whom examination is waived, shall pay to the treasurer of the board the sum of twenty-five dollars when recommended to the governor for a certificate. The board shall maintain a register of the names and addresses of all persons receiving certificates under this act. The members of the board shall receive as compensation for their services ten dollars per day for the time actually spent and the necessary expenses incurred in the discharge of their duties as members of said board: Provided, however, that all compensation for services and expenses shall not exceed the amounts received as fees from applicants. All bills for expenses and salaries shall be allowed in open meeting of the board and shall be paid from the fees received under the provisions of this act. All money received in excess of payments shall be paid into the state treasury at the end of each year, and so much thereof as shall be necessary to meet the current expenses of said board shall be subject to the order thereof, if, in any year, the receipts of said board shall not equal its expenses. The board shall make an annual report to the gov-

ernor, containing a full account of its proceedings, and render an annual financial account to the board of state auditors.

"Section 4. The governor shall issue certificates to those persons who are recommended to him by the board of accountancy as having qualified under the provisions of this act. The governor may revoke any certificate for sufficient cause, after written notice to the holder thereof, and a hearing thereon, and shall issue such notice whenever requested to by the board.

"Section 5. The board of accountancy may, in its discretion, register the certificate of any certified public accountant, who is a lawful holder of a C. P. A. certificate issued under the law of another state, and may issue to such certified public accountant a certificate of registration, which certificate shall entitle the holder to practice as such certified public accountant, and to use the abbreviation C. P. A. in the state: Provided, however, that such other state extends similar privileges to certified public accountants of this state. The regular fee of twenty-five dollars shall be charged for such certificate. Certificates of registration may be canceled in the same manner as section 4 provides for the revoking of certificates issued under this act.

"Section 6. If any person shall hold himself out to the public as having received a certificate, as provided in this act, or shall assume to practice as a certified public accountant or use the abbreviation C. P. A., or any other letters, words or figures to indicate that the person using the same is such certified public accountant, without having received such certificate, or after the same shall have been revoked, he shall be deemed guilty of a misdemeanor, the penalty of which shall be a fine of not less than one hundred dollars nor more than five hundred dollars for each offense, or imprisonment in the county jail for a period not exceeding six months.

"Section 7. Every person, having been granted a certificate under the provisions of this act, shall give a five-thousand-dollar bond to the secretary of state before entering upon his duties, for the faithful performance of the same."

ACCOUNTANTS' BANQUET

CERTIFIED PUBLIC ACCOUNTANTS MEET.

The Maryland Association of Certified Public Accountants held its regular monthly meeting last night at the Hotel Belvedere.

A motion was offered and unanimously passed that the Maryland association join the American Association of Public Accountants, which is the recognized national body of public accountants in the United States. After all business had been disposed of the meeting adjourned to the banquet hall where a circular table was arranged and the following menu served:

Little Neck Clams

Cocktail

Cream of Chicken a la Reine

Radishes Celery Salt Almonds Sauterre

Saddle of Lamb a la Jardinere

New Peas Pommes Rissoles

Fresh Asparagus

Sweetbreads braise a la Perigerieux

Punch

Roast Squab

Salad Romaine Champagne

Glave Fantasie Petit Fours

Cheese Perfectos Cafe

Among those present were Alfred Atkinson, Thomas L. Berry, Frank Blacklock, Ferdinand L. Brauns, Garry Brown, Alexander Dodd, C. R. Evans, A. C. Feuss, Eugene Greenway, Charles O. Hall, Charles L. Hehl, John Kuchler, Karl L. Lee, Raleigh T. Lilley, John U. Markell, C. V. Starkloff, Max Teichmann and John A. Tompkins.

The officers of the Maryland Association of Certified Public Accountants are

Thomas L. Berry, persident; Ferdinand L. Brauns, vice-president; Charles O. Hall, secretary; Charles L. Hehl, treasurer.

ILLINOIS SOCIETY

At the annual meeting of the Illinois Society of Certified Public Accountants, held on April 25, 1905, the following officers, directors and delegates were elected:

J. Porter Joplin, president.

C. J. Marr, vice-president.

R. S. Buchanan, secretary and treasurer.

Ernest Reckitt, John A. Cooper, Seymour Walton, Edward E. Gore, directors.

William H. Roberts, Edward Allen, auditors.

John A. Cooper, Edward E. Gore, delegates to federation.

The address of Mr. R. S. Buchanan, the new secretary and treasurer, is 189 La Salle street, Chicago.

FRANCIS W. RADFORD

The Washington Society of Certified Public Accountants has suffered a severe loss in the death of Mr. Francis W. Radford, who was the senior member of the society. The following resolution was passed by the society at a meeting held April 28:

"Whereas, It has pleased the Supreme Ruler of the universe to remove from our midst, Francis W. Radford, a fellow and charter member of this society. It is hereby

"Resolved, That by his death, the members of this society have sustained a loss of a highly esteemed colleague and friend, whose wise council and fellowship they will sadly miss; that they extend to the bereaved wife and family sincere sympathy in the sad affliction thus experienced; that this resolution be entered upon the records of the society, and that a copy of the resolution to be sent to the widow of our late brother."

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Articles appearing in THE AUDITOR are *not* to be read as having received the endorsement of the society, but are to be taken as individual expressions of opinion, and as such may be answered in future issues. The Editor invites contributions from all Accountants.

A noticeable feature of the meetings of the associations or other bodies representing different lines of business is the prominence which is being given to the subject of accountancy. The bank clerks and the street railway men seem to be especially interested in this question, and have listened to frequent addresses from members of their own associations on topics of this nature. In fact, it would appear that everybody is extremely interested in the subject of accountancy, except the accountants themselves, for no effort has ever been made by the directors of the Illinois society, nor, so far as we know, by any other society, to bring the importance of accountancy to the attention of any society or body of men by delivering proper addresses before them. The single exception was an address before the bankers of this state last fall, which was of importance principally as an object lesson to show that business men would welcome the public accountant to their meetings, if he were sufficiently mindful of his own interests to attend, and would take the trouble to prepare a paper on some subject that would hold the attention of his hearers. It would be better for the speaker if he had a more formal standing before the meeting than his individual position in the profession would give him, and therefore he should be sent to the association before

which he is to speak, as the official delegate of the C. P. A. society to which he belongs. Apparently, however, the different societies of accountants are entirely satisfied with the condition of the public mind as it is found at present, and do not think it advisable to do anything to educate the business world in regard to the importance and value of the services of the certified public accountant. Possibly the reason for this lies in the high standing of the members of the board of directors, which has given them so much business that they do not appreciate the necessity of extending the field covered by the profession. Whatever the reason, it is undoubtedly true that no effort has been made to bring the peculiar work of the accountant to the notice of the general public in any official way except by the establishment of this magazine.

In this connection we might say a word about the individual accountant and his disinclination to appear in print. Several subjects have been suggested in these columns on which discussion was invited, subjects that are of interest to every accountant and to the majority of business men, and not a single accountant has taken the trouble to write even a short article on any one of the topics.

Unless the profession is itself alive to the importance of bringing the value of its services to the attention of the public, it is idle for us to complain of the inroads made into our business by the stationery salesmen who are posing as accountants.

Pluck wins; it always wins, though days be slow,
And nights be dark 'twixt days that come and go—
Still Pluck will win; its average is sure.
He wins the most who can the most endure,
Who faces evils, he who never shirks,
Who waits and watches, and who always works.

The Auditor

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No. 4.

THE PROFESSION OF THE PUBLIC ACCOUNTANT

A LECTURE DELIVERED TO THE EVENING SCHOOL OF ACCOUNTS AND FINANCE OF THE UNIVERSITY OF PENNSYLVANIA ON MONDAY, MARCH 10TH

BY ARTHUR LOWES DICKINSON, M. A., F. .C. A., C. P. A.

The growth of the profession of Public Accountant in the United States, during the last ten years, has attracted much attention among all classes of the commercial community, and the organization and work of such schools as the Evening School of Accounts and Finance, and the New York University School of Commerce, Accounts and Finance, is the best evidence that the profession appeals to educational authorities as affording opportunities of profitable occupation and advancement for men of superior ability and attainments. It is no doubt for this reason that the subject of this lecture was suggested as one that would be of interest to members of this School, in giving them a short account of the profession in the past and in the present, and at the same time informing them of the aims and objects which its leaders have in view for its future development.

The date of origin of Public Accountancy as a profession is a matter of speculation, mainly because it is a gradual evolution from the occupation of the bookkeeper (also formerly and still styled ("Accountant") through that of "Auditor" (in the sense in which the word is used to describe a corporation official) to that of a skilled business investigator. The Public Accountant of the present day may be defined as:

A person skilled in commercial and finan-

cial affairs, and particularly in the accounts relating thereto, and competent to investigate and report thereon; who continuously places his services at the disposal of the general public for remuneration.

While the science of Bookkeeping and Accounts is probably as old as civilization itself, the practical combination thereof with the science of Commerce and Finance as now understood and the application of the theories and practice resulting therefrom to the benefit of the public, is of comparatively recent origin.

The oldest organized body of Public Accountants in existence is the Society of Accountants in Edinburgh, which was incorporated by Royal Charter in 1854; but even at that date there was a very distinct idea of a profession, for the petition for the Charter recites that "the Profession of Accountants, to which the Petitioners belong, is of long standing and great respectability, and has of late years grown into very considerable importance: That the business of Accountant, as practiced in Edingburgh, is varied and extensive, embracing all matters of account, and requiring for its proper execution, not merely thorough knowledge of those departments of business which fall within the province of the Actuary, but an intimate acquaintance with the general prin-

ciples of law, particularly of the law of Scotland; and more especially with those branches of it which have relation to the law of merchant, to insolvency and bankruptcy, and to all rights connected with property."

The Edinburg Society was closely followed by the Institute of Accountants and Actuaries in Glasgow, incorporated by Royal Charter in 1855, which is celebrating its jubilee in this month of March, 1905, and later on by the Society of Accountants in Aberdeen, which received its charter in 1867.

In England there were in various towns local societies, the leading one being the Institute of Accountants formed in London in 1870, but it was not until the granting to the Institute of Chartered Accountants in England and Wales of a Royal Charter on May 11, 1880, that the term "Chartered Accountant" as the degree of the profession was recognized there. In view of the development of similar organizations in the United States, it is interesting to note that at the time of the granting of the Royal Charter, the Institute of Chartered Accountants was required to admit as a fellow every person who was in practice as a Public Accountant on January 1, 1879, and who up to the time of his applying to be admitted a Fellow had been continuously in practice as a Public Accountant for five years. It is generally believed, although there is naturally no specific evidence on this point, that many were so admitted who in the higher view taken at the present day of the qualifications necessary for the profession, would not be considered eligible. From the date of the granting of that Charter, the profession has grown largely in numbers and in standing, and, including the younger Institute in Ireland, there are approximately four thousand Chartered Accountants in Great Britain and Ireland at the present time, of whom not less than two-thirds are in practice on their own account, and it may safely be said that

throughout Great Britain the Chartered Accountant, as a class, is recognized as a member of a learned profession of equal importance to the business community with the lawyer and the engineer. In Canada also the profession is well established under the same degree of Chartered Accountant, the use of which is restricted to the members of the following Societies, comprising a membership of approximately one hundred:

Association of Accountants in Montreal, incorporated by Royal Charter July 24, 1880.

Ontario Association of Chartered Accountants, incorporated by Royal Charter Feb. 1, 1883.

Nova Scotia Association of Chartered Accountants, incorporated by Royal Charter March 30, 1900.

Manitoba Association of Chartered Accountants, incorporated by Royal Charter May 15, 1902, and lastly the Dominion Association of Chartered Accountants incorporated by Royal Charter November 8, 1902.

(The latter was incorporated as a National body to bring together the members of the different provincial Associations.)

In Great Britain it is necessary that the aspirant to membership of the profession be apprenticed to a member of one or other of the Associations of Chartered Accountants for a term of five years for the purpose of practical instruction. This term of service is considered so necessary and of such value that premiums, varying from \$250 to \$2,500, are paid to employers for the privilege of working in their offices; and as a rule the "Articled Clerk," as he is styled, receives no salary during this term apprenticeship. Before he is articled he is required to pass a preliminary examination or to have passed equivalent examinations elsewhere as a guarantee that he has had a first-rate general education; and during and at the end of the term of apprenticeship he has to pass two further examinations. The

subjects laid down for these examinations are the following :

Bookkeeping and Accounts (including Partnership and Executorship Accounts).

Auditing.

The Rights and Duties of Liquidators, Trustees and Receivers.

The Principles of the Law of Bankruptcy.

The Principles of the Law relating to Joint Stock Companies (here known as corporations).

The Principles of Mercantile Law.

The Principles of the Law of Arbitration and Awards.

And the Scotch Societies, under somewhat different headings, including the same subjects and in addition :

The Elements of Actuarial Science, and The Elements of Political Economy.

When the student has completed his term of articles, and has passed his final examinations, he is then eligible for admission as an associate of the Institute. If he then commences practice on his own account as a principal, and continues therein for five years, he can, without further examination, take a degree of "Fellow," and it will be seen, therefore, that the latter degree insures not only a thorough knowledge, tested by examination, of the theory of all the subjects which are necessary for the practice of his profession, but also practical experience in the application of these principles, both as student and as Principal.

The Scotch Societies give only one degree, namely, that, of Chartered Accountant, and no distinction is made between members of the Society in practice, or not in practice.

These qualifications, and in particular the necessity of serving a term of apprenticeship, made it difficult for many who considered themselves otherwise competent to acquire the degree of Chartered Accountant; and accordingly, in 1885, another body, known as the Society of Accountants and Auditors, was incorporated in England under the laws relating to Joint Stock Com-

panies. In its early stages this Society admitted as members a large number of individuals without any examination, and without requiring any special term of service nor was it necessary that its Fellows, as is the case with Fellows of the Institute of Chartered Accountants, should have had any actual practical experience in their profession. Many of its members were, and are at the present date, officers of corporations or municipals bodies, who are not, and never have been, Public Accountants in the proper sense of the word. During recent years, as might be expected, the membership of this body has grown largely, and in 1902 new regulations were adopted under which a candidate for Fellowship is required to have been continuously in practice as a Public Accountant for not less than seven years immediately prior to his application. To become an associate, it is necessary to pass certain examinations and the Board have discretionary powers to require service under Articles for five years; but a longer term of service will be accepted in lieu of Articles. The general scheme and the subjects for examination under these new regulations, are almost identical with those of the Institute of Chartered Accountants; and the standing of the Society has improved to such an extent that those of its members who are in practice as Public Accountants, are duly recognized as professional men, though perhaps on a lower standard than the Chartered Accountant. At the present time there appears to be approximately two thousand members of this Society in Great Britain and the Colonies, of which perhaps 1,200 are in practice as Incorporated Accountants.

The existence in England of these two somewhat conflicting bodies has not been a benefit to the profession in that country, and it is mainly owing to the opposition which one body generally gives to every proposition for legislative action put forward by the other, that in spite of the gen-

eral recognition of the profession by the commercial community, no general legal recognition has yet been obtained; and with few and unimportant exceptions, no mention of the title of "Chartered Accountant" or "Public Accountant" will be found in Acts of Parliament containing provisions relating to accounts. About eight years ago an attempt was made to bring about an understanding between the two bodies and to promote a joint bill in Parliament for the registration of all practicing accountants, not in any way interfering with the degrees given by the existing Societies, but providing that no one should be allowed to practice as a Public Accountant unless he was so registered in accordance with the Act. Unfortunately, by the action of the majority of the members of the Institute of Chartered Accountants this eminently reasonable compromise was defeated and the possibility of any further action in this direction now appears to be remote. As a result of the partial closing of the door by the Society of Accountants and Auditors, other Societies are springing up, and unless a Registration Act is passed, there seems no reason why this process should not be continued indefinitely to the great detriment both of the profession and the community. It is interesting to note that within the last few months, largely through the efforts of the Society of Accountants and Auditors, such a registration Act has been passed in the Transvaal, the youngest of British Dependencies, and it is to be hoped that the example so set may eventually be followed in the Mother country.

The duties which are entrusted to the Chartered Accountant in Great Britain, in addition to all matters relating to accounts, include also appointments, whether by the Courts or by individuals, as Trustee in Bankruptcy, Liquidator of Companies, Receiver of Estates or Commercial Undertakings, Arbitrator in disputes between corporations or individuals (particu-

larly where the subject matter of the arbitration has relation to accounts), and Secretaryships of small corporations, providing under contract office room and staff. The Public Accountant is regarded not merely as a man skilled in accounts of all kinds, and with special training in business affairs, but his reputation for ability, integrity, impartiality, and responsibility is such that he is naturally selected for temporary positions in the business world requiring such qualities, in preference to the members of other professions. He is treated by his clients as their confidential adviser on all business questions; in fact, in Great Britain there has fallen to the Accountant a very large proportion of the duties and responsibilities of general business adviser, which in this country are at present almost entirely in the hands of the legal profession. Individual members of the profession have been frequently recognized by the British Government, and it is interesting to note that within the last few weeks the name of a leading English Accountant has been included as the representative of the profession in a committee appointed to consider amendments to the law relating to Joint Stock Companies or, as they are called here, Corporations.

The somewhat lengthy description here given of the profession in Great Britain, and the high position which it has there established for itself is of importance in considering its present standing and future prospects in this country, where it is still only in the earlier stages of development.

The first official record of the existence of the profession in the United States is the charter of the American Association of Public Accountants, which was granted under the laws of the state of New York on August 20, 1887. It was soon felt that the profession ought to have some definite degree of its own, corresponding to the term "chartered accountant," which at that time had become fairly well known in America.

The matter was taken up energetically, and the result, after several years of hard work, was the passage in 1896 of an act of the Legislature of the state of New York, creating the degree of "certified public accountant." Under this act the regents of the University of the State of New York appoint a board of examiners, consisting of three certified public accountants, and examinations are held twice a year in the following subjects:

Theory of Accounts,
Practical Accountancy,
Auditing, and
Commercial Law.

The law also provided for the admission to the degree, without any examination, of all those who had been practicing in the state of New York as public accountants for one year prior to the passage of the act. Similar acts have since been passed in the states of Pennsylvania in 1899, Maryland in 1900, California in 1901, Illinois in 1903, Washington in 1904 and New Jersey in 1904, the main provisions of these acts being shortly, as follows:

They all require that applicants for certificates must be citizens of the United States, or have duly declared their intention to become such (except Pennsylvania and New Jersey, which require full citizenship), must be of the age of twenty-one, and must reside or practice in the state. They all contain a waiver clause of more or less stringency, under which accountants practicing at the date of passage of the act were admitted to the degree without examination if they applied within a limited time, generally one year. They all contain over for the authority granting the degree to also revoke it for good cause shown and confine the use of the degree to those to whom it has been duly granted; except in the case of Illinois, which permits its use by those holding a similar degree from another state, and New Jersey which has adopted what is known as the "reciprocal clause," to which further

reference is made. In Pennsylvania, California and Illinois the subjects of the examinations are specified in the acts; in other states the examiners settle the subjects. In all cases, however, they are the same as required in New York state. The states of New York and Illinois have made the State University the authority for granting the degree, but all other states place the authority with the governor of the state, thus making a separate political, as opposed to an educational department. The board of examiners, by whomever appointed, must in all cases consist of not less than a majority of certified public accountants, the other members, if any being lawyers, except in Maryland, where the board consists of two certified public accountants and two lawyers.

The acts here shortly summarized represent the best which the profession has yet been able to secure, but all are defective in two most important particulars. In the first place none of them call for any practical experience as a necessary qualification for the degree; and, secondly, they make no attempt to regulate the profession or, even, with the exception of New Jersey, to control the resident holders of certificates granted by other states.

New York state was the first to recognize that the mere holding of a certified public accountant certificate, as a result of an examination in the elementary principles of the profession, but with no experience in the practical application of those principles, was not sufficient, and the board of regents a few years ago, under authority given them in the act, altered the rules so as to provide that a candidate on passing the examination should be only entitled to what is known as a junior certificate, and that the full certificate should not be issued to him until he had satisfied the regents that he had had three years' experience in the practice of accountancy, of which at least one year had been in the office of a prac-

ticing public accountant. This is a step in the right direction, but in view of the much higher practical qualifications required in Great Britain it may be doubted whether the required standard is yet attained. If the professional degree of certified public accountant is to attain an equally high standard with that of the similar degree of chartered accountant in Great Britain, it is essential that it should not be conferred on lower qualifications, and some equivalent term of practical experience should be insisted upon.

Under all the acts a certain latitude is given to the examiners, or other authority constituted to administer and to make rules, and it would seem that by a modification of these rules a higher standard could gradually be introduced. There is an increasing consensus of opinion among public accountants that, if the degree is eventually to be of value as the hall mark of the profession, at least three years' practical experience in the office of a public accountant, followed at the end of that period by a second examination, should be requisite

for a full certificate. Any higher qualifications of practice must probably rest with the accountants' societies, who can at any time raise their standard for fellowship.

The period of probation required must be looked upon by those who intend to follow the profession as the equivalent of the similar period which the young lawyer, who has passed through his law school, spends in the office of a practicing attorney—namely, as part of his education, during which his services, while of some value to his employer, cannot command the same salary or remuneration they would in a trade or business.

The other defect noted is of even greater importance to the profession. All states except Illinois and New Jersey, merely prohibit the use of the term "certified public accountant" by those who have not obtained the degree of the state. This means that the holders of a degree of another state must add the name of that state after the words "certified public accountant." Illinois throws the door wide open to all those holding a similar degree from another state.

(To be continued.)

COUNTY ACCOUNTS

BY WILLIAM C. FOSTER.

There are no accounts more simple than those of county officers, referring particularly to county auditors and treasurers. These accounts are on a cash basis. There is no reckoning with profits or losses, with bills payable or bills receivable, nor with a multitude of other accounts which may enter into the ordinary business of the same magnitude and which so often prove a stumbling-block. With a receipt, usually numbered consecutively, to account for every dollar disbursed, and a numbered stub or duplicate to account for every dollar received, there would seem to be little excuse for anything but accuracy.

The fact is, however, that many shortages occur through no other fault of the officer than ignorance of even the rudiments of bookkeeping. Very frequently these shortages become public and are dignified by the term defalcation; at other times a mortgage on the farm or homestead is the only public evidence of the price paid for ignorance, and again, such shortages go undiscovered from one administration to another. The fault? A lack of proper checks, without which no account can be kept accurately. Checks alone make the infallible accountant.

County officers are usually taken from the farm or from the shops. It may be no det-

riment to the candidate that he is fitted by experience or otherwise for the position he seeks, but in most instances this fact would be of no assistance to him in attaining his election. The result is that many officers assume their duties without a very clear idea of their responsibilities.

The officer opens his account with a "balance" turned over by his predecessor and seldom with any knowledge of his own that such balance is correct. He continues the ledger accounts from the point where his predecessor left off, falling into all the errors that preceded. The public examiner may chance to make a thorough examination of the accounts of the office, discover a shortage, and the result is the mortgage. After a battle between contending political factions, with charges of graft, an accountant may be called in, and there is a defalcation with attending scandal. With neither of these contingencies shortages may unconsciously be permitted to run until lost in antiquity, for my experience is that the annual or semi-annual "checkings" made by committees from the boards of county commissioners or supervisors is so universally superficial and utterly worthless as to be unworthy of consideration.

Many of the states have provided for an official known as the public examiner, whose duties, among others, require him to make periodical examinations of county accounts in the same manner as the national bank examiner investigates the banks in his district. Such an officer may be, and usually is, of great value. He should be the medium through which suggestions for better methods are made, as well as the auditor who seeks to know that the money is intact. I have found officers usually thankful for suggestions of this nature—willing and even anxious to correct faults in their systems. But sometimes the public examiner, appointed for political reasons, is himself in need of instruction in the matter of accounts,

and the office is then valueless to every one but the examiner, and a positive detriment to the county officer.

Rotation in office, that is, limiting by statute the time one may hold an office, is common in some states. The usual limit is two consecutive terms of two years each. The theory of such rotation is to turn the "rascals" out every four years—the practice is that the officer is legislated out of office about the time he has fitted himself to be a valuable official, to make way for another novice. A public accountant might, with equal reason, discharge his trained assistants every four years to replace them with apprentices. The practice is distinctly bad from the point of view of the public welfare and efficiency in office.

There is one method that should be followed in the matter of county accounts and, indeed, in all accounts of a similar public nature. At the end of each official term, or, better, at the close of each fiscal year, an expert accountant, one who is removed from local political influence, should be employed to make an examination for the previous period, and a written report for the benefit of the public. This practice is in vogue in some counties in western states and I have never known of an instance of its being discontinued after once having been begun.

Its merits are obvious. It is usually less expensive than the total per diem drawn by the county board in attempting to do the same work. It has prevented the loss of money by the county, whether such loss threatened through bad methods or otherwise. It satisfies both the outgoing and incoming officer, and allays public criticism. And finally, the public—the tax-paying public—is entitled to this expert information as to the disposition of the funds which it contributes, under penalty of "due process of law," for the support of the local government.

ERRORS OF PRINCIPLE.

SEYMOUR WALTON, C. P. A.

Auditing is for the purpose of discovering the existence of fraud, of technical errors, and of errors in principle. Of these three the last is by far the most important and it is the one which the professional accountant is striving to bring most forcibly before the business world. He is trying to disabuse the mind of the office manager of the idea that the principal object of an audit is to discover a possible shortage in the accounts. No one knows better than the professional accountant that the vast majority of men are honest, for no one knows better than he, that there are multitudes of men who are in charge of accounts so loosely kept that there is plenty of opportunity offered for their manipulation with hardly a chance of discovery, and yet who are absolutely true to the trust reposed in them. Knowing this, he also realizes that the principal advantage of an audit accrues to the benefit of the bookkeeper and not to that of his employer. The bookkeeper knows that his accounts are correct and that his employer thinks that they are. After a careful audit he knows that his employer *knows* they are correct and that his own position is now based on the certainty of facts and not on a blind faith. We have the best of authority for saying that faith without works is dead and can safely infer that the best kind of faith is that which is founded on proof. In addition to this the auditor is frequently the best friend of the bookkeeper by his insistence that the head of the office shall observe the proper rules himself as well as demand their observance by his subordinates. Business men are very apt to be lax in their methods where their personal account is concerned. Hurrying out of the office they

are very prone to say to the cashier, "Give me \$10 and charge to my personal account." If asked to give a receipt they are apt to decline and the cashier is not in a position to demand it. The auditor, however, not standing in as great awe of the boss will certainly require that he give a proper voucher for all money drawn or else that he will acknowledge the correctness of his account at the time of the audit, that is, if he is an independent auditor and not on the regular staff of the office. A signal instance of the protection this would have afforded the bookkeeper came under my notice a number of years ago. The head of the business was a comparatively young man named Boyd. He was in the habit of telling his bookkeeper McConnell to take \$50 or so out of the cash, charge it to his account and to accompany him in a tour of the town. No voucher was given and no complaint of error in his personal account was made by Boyd for several years, when he quarreled with McConnell and then repudiated every one of the transactions, claiming that all the entries were false and that they were intended to cover an embezzlement by McConnell. McConnell was arrested and tried and it might have gone hard with him, if he had not been able to prove Boyd's instructions to him by some of the clerks in the office who had several times overheard them.

It might be an interesting study to take up the various methods employed to cover fraud in accounts, but the gentlemen composing this society are probably thoroughly posted in regard to the majority of them and it would be a waste of time to discuss any except perhaps those involving errors of principle which will be the

main theme of this article. Still less profitable would it be to take up technical errors, that is departures from mechanical accuracy. The professional accountant always avoids, if possible, employment on books that are badly out of balance; unless fraud is an element of the errors, because it takes so long to find the differences, if the books are at all complicated or the records are voluminous, that the clients are liable to be appalled at the cost and to feel that they have paid more for the work than it was worth to them to find a few clerical errors.

It is where errors in principle have been made that the auditor finds occasion for the use of his greatest abilities and that he is able to render to his client the most valuable service. These errors usually arise from a lack of clear thought and of the ignorance of the fundamental law of accounts. It has been said that the only use some people have for their heads is to keep their collars from slipping off and it sometimes seems to be true in the light of some methods practiced by men who are honestly convinced that they are right. One of the most common sources of error is the inability to distinguish between assets and liabilities on the one hand and profit and loss items on the other. A street railway company prided itself on possessing a conservative feature that was very uncommon. They intended to provide out of the current earnings, reserve accounts to cover their interest, taxes, insurance and accidents. What they did was to open accounts in a savings bank with reserve for interest, reserve for taxes, for insurance and for accidents, depositing in each account respectively 1-12 of the annual interest, taxes and insurance and 2 per cent of the gross earnings to cover accidents. No charge was made in their operating accounts against any of these four accounts until payments were actually made for items belonging to them. There

was simply a transfer of funds from the general cash to the savings bank and they could not see that it was only a change in the location of the cash and not in any way a charge against their operation. In other words, they could not distinguish between the asset of cash and the profit and loss item of operating expense. Their method came out about right with their interest, insurance and taxes, the annual amounts of which were known, but they were right only at the end of the year when the items had been paid. During the intermediate months they had really done nothing to get the items into their operating expenses. In the case of the reserve for accidents, however, they were not even right at the end of the year, for they had on hand in the savings bank some \$3,700 to the credit of the fund, being the result of the 2 per cent contribution above the actual accident cost. They did not know how to dispose of it. If they charged operating with the \$3,700, they would have charged out as paid an amount which they still had in the bank, and they knew enough to realize that that would not do. It took a little time and considerable argument to show them that they should have made a journal entry each month charging accidents and crediting reserve for accidents with the 2 per cent. This would bring the amount into the operating expense exactly as if accidents had been paid for to that extent and would have created a true reserve fund to which actual accident cost would be chargeable, the balance showing always as a liability for future accidents. It was entirely immaterial whether they made a special deposit of the money in a separate account or allowed it to remain in the general bank account. The essential point was in the charge to operating and the formation of a correct reserve fund account. The difficulty in closing the books vanishes since there is now an expense

account to be charged off to profit and loss. Sometimes the error in principle arises from the inability to see the true nature of the transaction. Some time ago a street railway made a statement to prospective buyers of the entire stock showing net earnings of 8 per cent per annum for a period of nearly two years. The statement was made by the secretary and was said to be a correct copy of the books. The intending purchasers sent an accountant to verify the statement, which was found to be absolutely correct as far as the books were concerned. But there was an item of \$50,000 to the credit of profit and loss which arose in this way: The company was a combination of three other companies. In acquiring the constituent companies payment was made in stock, bonds and some money. One man who received \$100,000 of the stock offered to sell it back to the company for \$50,000. As the company had just floated their bonds, the offer was accepted, treasury stock account was charged \$100,000, cash of course was credited \$50,000 for the money paid and the question was what to do with the other \$50,000. This question the secretary answered by crediting it to profit and loss, and what was worse, he included it in the gross earnings in his statement. He was perfectly honest about it and was very angry when the accountant threw it out and credited it to plant and franchise account in the statement he made for his clients. A very simple analysis of the relations between the capital stock and the plant and franchise account showed that the capital account really represented no actual value, since the road had been as usual purchased entirely with the bonds and in order to offset the fictitious credit to capital the plant and franchise account had been swelled to a corresponding amount beyond its real cost. In other words, the capital was all water and the transaction consisted simply in squeezing

\$50,000 of water out of the plant, which should therefore have been reduced to that extent. Even granting that the good-will of the franchise was worth the whole of the capital stock account and that in consequence the item was to be considered a legitimate profit it was in no sense an operating profit, but an accidental and sporadic one that should have been separately stated. In spite of the arguments of the accountant the secretary stood his ground and afterward furnished his own figures to the brokers that negotiated the sale of the bonds and they were published by the brokers as a true statement of the earnings of the company.

This same street railway company's statement afforded an example of an error of omission. The statement was made for June 1. The coupons on \$750,000 of bonds were due July 1. The statement included all the earnings for the previous five months, but took no account of the interest accrued but not due for those months. When the accountant incorporated in his statement a liability of \$15,625 for accrued interest, the secretary made another vigorous protest, claiming that the interest was not a liability until the coupons were actually due, and was apparently not convinced when he was shown that by his method he would load the month of June with the whole burden of the six months' interest, amounting to \$18,750. There were other items which he had ignored, coupons which were due but had not been presented and rent of park property of which five months had accrued. Altogether the true condition showed a net profit of $2\frac{1}{2}$ per cent per annum instead of 8 per cent as claimed by the secretary, and the accountant's clients refused to buy. Incidentally the accountant discovered another error of principle when he made his report to the agent in Chicago of the New York parties who were negotiating for the purchase of the

road and this time it was a breach of moral principle much more serious than the honest errors of the secretary. He found that the agent while representing the prospective purchasers on the one hand, was on the other to receive a commission from the sellers if the deal went through, and was consequently more than ordinarily disappointed at the adverse report.

An error that is quite common is found in the treatment by the home office of sales to branches. It is very convenient to treat a branch as an ordinary customer and to charge it with goods sent it at the regular selling price which of course includes the usual profit. But by so doing the profits of the home office are swelled beyond their true amount, since the sales are not actual until the goods are sold by the branch. There is an instance on record where the manager of a bicycle factory wished to make an especially good showing for the year and accomplished his purpose by shipping an abnormally large quantity of goods to each of the many branches, billing them at the regular selling prices. On the strength of the excellent business thus shown the manager was enabled to sell his stock at a considerable advance, when he resigned and left the rest of the officers the task of explaining to the stockholders the reason why the business of the next few months showed the marked decline that resulted.

If, on the other hand, the goods shipped to branches are billed at cost and passed through the regular sales account, the latter account is swelled so as to destroy the basis of percentages of selling expense and of profits to sales, if such percentages are used for the information of the company's officers.

The best way to handle the accounts is to credit the sales to branches to a branch sales account, whichever way they are billed, for in this way the business of the branches is shown separately from the

regular business and a separate profit and loss statement can be made up for them.

When the sales made by the branch are reported to the home office and all collections are made from the home office, the branch becomes a selling agent merely and no accounts at all are kept with it, except for the expense accounts, which are usually taken care of by advancing a definite sum to the branch to begin with and then sending them checks from time to time for the specific amount of the expenses paid to date.

When a proper system of accounts is kept, in which manufacturing is kept separate from selling expense, it is necessary to divide the freight account into in-freight and out-freight. In-freight is unquestionably a part of the cost of the goods and should eventually be charged to it. This is readily seen when we consider the case of goods shipped f. o. b. destination where the freight has been allowed for in quoting prices. The whole cost is then charged up without question. There is no difference in principle between goods thus bought and those bought f. o. b. shipping point, except that in once case the buyer pays the freight to the seller and in the other to the railroad company. And yet we often find no distinction made between the two classes of freight. Charges on returned sales, while in a sense in-freight, should of course belong to out-freight as a selling expense. Expressage and cartage would be included in the freight account. Where the house does its own carting there might be some difficulty in reaching an accurate distinction and it might be best to adopt a conventional rate of division based on experience.

An error that is sometimes made consists in treating consigned goods as if they were actual sales. I have known cases where very large quantities of goods sent on consignment were passed through the regular sales book as ordinary sales with

nothing to show that they were any different from the rest of the sales. It was not until attention was called to the fact that certain customers had abnormally large

debit balances and that they were very slow in remitting that the true nature of the charges to their accounts was discovered.
(To be continued.)

WATERED STOCK

A LECTURE DELIVERED TO THE EVENING SCHOOL OF ACCOUNTS AND FINANCE OF THE UNIVERSITY OF PENNSYLVANIA

BY CHAS. N. VOLLUM, C. P. A.

(Concluded from May issue.)

Note fluctuations of intrinsic value. The manufacturer has his intrinsic value on an article when he sells it to the jobber, the jobber has his intrinsic value when he sells the same article to the retailer, and the retailer has his intrinsic value on the same when he sells it to the consumer, and here we have three intrinsic values all on the same article, and all right from the standpoint of the different owners, but the *real intrinsic value* is only the *cost of manufacturing*.

If we take "intrinsic value" as being the outlay necessary to replace, say a machine—we are up against another uncertainty—whose intrinsic value shall it be, the manufacturer's, the jobbers or the retailer's?

I think, however, I have said enough about intrinsic value to show that it is a very uncertain quantity.

NOW TO OUR SECOND QUESTION.

Is the system of organizing a corporation with a capital based on the earning capacity a good business proposition?

Capital is the amount invested in a business and includes good-will and franchises as well as visible assets.

Earnings are the results obtained by operations of such business.

This question in connection with our subject presumes that an amount of stock

has been issued covering not only what may be considered a fair value of a business under the old method of financing, but in addition thereto enough to cover a promoter's fee for organization, for you must understand that almost all the corporations formed in recent years have been through the purchase of corporations having a previous existence and business, and the intent of a combination has been to increase earnings by reducing expenses, etc.

If the stock or bonds issued in such combination results in putting fixed charges on the new company *that it cannot possibly meet—the dividing line between honesty and dishonesty in such a transaction is so indistinct as to be hardly perceptible*, and yet such combinations are made.

If, however, the promoter receives for his compensation, say, a certain cash consideration from sale of bonds, which would be capitalized, and the fixed charges thereon, form but a trifle of the savings made by the combination, and the balance of his fee is paid in common stock, which is no drain on the company—does it not seem that the new company is in a good position to reap the benefit of its savings, which means that it is a good business proposition? All investments have one object in view and only one, and that is the *income* that can be obtained from the investment.

The question of a sale of investments is

very seldom considered when good income is derived therefrom, except where discredit is thrown on a company, in some cases rightfully, in others wrongfully, but capital is timid, very timid, and the best investments may have their ups and downs in value or rather quotations in the Stock Exchanges, without changing actual conditions one iota.

Is there any other good business way of ascertaining the value of a Corporation except through its *earnings*, and if the earnings of a Corporation will pay a good interest on \$1,000,000 capitalization, is not that Corporation worth one million dollars, as long as it can pay that amount of interest from its earnings?

It does not seem that this question requires much in the way of argument to prove that the only proper valuation of a Company is its earning capacity, and it is not very hazardous to say that upon that basis, as a good proposition, any Company can be organized without detriment to its Shareholders or Bondholders.

The cry will continue to go up from the "intrinsic value" or "dollar for dollar" preachers, that inflation of values is dangerous, and so it is, when inflation means putting charges on a Company that it cannot stand; but when the earnings are really the only circulating medium of a Corporation, and the Capital is a permanent fixture, we may, without harm, relegate the question of Capital to some future time, and scan the earnings closely, to see if we cannot get a little more dividend, leaving the question of the value of each separate asset to theorists.

NOW TO OUR THIRD QUESTION.

"To what extent is the public interested in such matters?"

The answer to this question can only be: "Not at all, except as Stockholders and Bondholders."

I am alluding now entirely to the question

of the formation of a Corporation, its conduct and its earnings.

The public is interested in *the methods* of a Corporation or Trust that, by reason of great wealth, form combinations that result in oppression to the public.

Public Utility Companies may be saddled with fixed charges that keep the prices to the public for services, above what the public think they should pay for such services.

But it does seem that even here, there is "much cry and little wool."

The day of the public "be damned" is gone—never to return.

The public is taken care of and their smallest wishes attended to.

Prices for everything are lower to-day than ever known before, if we take into consideration the enhanced cost, made so, by the demands of labor for increased pay.

The percentage of profit on account of business done in many Corporations is so small that it would seem ridiculous to old-time merchants.

It is an unfortunate fact that combinations must work a hardship to small traders, but that is a situation that cannot be overcome.

The man of capital always has had the advantage over a man of small means and always will.

The only interest therefore that the Public can have in Corporation matters is where they are Stock or Bondholders or where they are injured by the *methods of business* of the Corporations.

There is no doubt that many Corporations are formed to conduct a business that, from its very nature, the risks should be assumed by individuals, and any Corporation organized purely and solely for the purpose of limiting liability in an uncertain venture, and failure results, brings the percentage of failures of Corporations nearer the percentage of failures of individual enterprises.

OUR FOURTH QUESTION IS.

What safeguards should be provided by

legislation to protect Stockholders of Corporations?

Corporations have certain rights and privileges which carry with them grave responsibilities and among the rights is the one to carry on their business with the same restrictions as to publicity as now governs individual enterprises.

As you are aware, the Corporation Laws of the different States are not uniform, some requiring a volume of information each year, of no practical or statistical value, but the blank reports demanded to be filled up, seem to be the emanations of a disordered brain, while other States require little or no information, and in fact what information they get is in part guesswork, on account of the need of a practical man to formulate the proper form of report.

In some States, the requirements, on the face of the law, appear to cover all points even to the verification of the reports of operations by auditors, but it is said that this part of the law is complied with by calling in the elevator boys to act as auditors and sign the reports.

I will not vouch for this, however.

An agitation has been going on for some time as to what form the oversight of corporations should take, and I notice that the House Committee on the Judiciary has authorized a favorable report on a bill requiring all Corporations engaged in Interstate Commerce, to make annual reports to the Commissioner of Corporations of the Department of Commerce.

This bill exempts common carriers from its operation, as railroads are required to report to the Interstate Commerce Commission.

The reports required by the bill are to be filed by February 1st of each year, covering the year preceding to December 31st.

The information is to contain the name of the Corporation, the statue under which organized, constituent Companies, amount

and value of Stocks and Bonds, and property, constituting capitalization, elements upon which the market value of same is fixed, earning capacity of same, name and address of each officer, rules and regulations of business.

The return is to be made under oath, and failure to do so lays the Corporation liable to a restraining order from engaging in, and the conduct of business until the return is made.

Congress adjourned, however, without passing this bill.

It would seem by this bill that an attempt will be made to go further than the exercise of Federal supervision of the *methods* of corporations doing an interstate business, and cover the details of operations of all kinds.

The wisdom of this course is doubtful.

If the information received is to be used as a basis for statistics for public information, the rights of Corporations to secrecy as to the results of operations is violated, and a case can be readily imagined, where a knowledge of the temporary financial condition of a Corporation would result in ruin to the Corporation.

It might be said in answer to this point, that the information given to the department is not open to public inspection.

This sounds well, but practically we all know, that in public offices, the contents of documents filed therein, somehow or other become public property, without the authorities being able to discover the source from which the information was obtained.

Another point may be touched upon and that is the practical question.

What benefit will it be to the Bureau of Corporations to know all the details of the operations of Corporations, and, if the financial operations of a Corporation are not in consonance with the views of the head of that department, what steps can he take to make them conform to his views?

Every business man and every board of directors must have knowledge of his or their business, that it would be the height of folly to let his or their competitors know.

Another point that seems to rise before us is, whether paternal government of this kind is in accordance with our institutions, and if so, why should it not be extended to large individual business interests.

The fact is, that such supervision by the Federal Government is grand paternal government, viz., the exercise of a supervision of a child of a child.

The parent of a Corporation is the State granting its Charter, and the supervision of its domestic and internal details should be, it would seem, a matter for its Creator to exercise, and to exercise in fairness and good faith—and any Federal supervision should cover the question as to whether its *methods* worked injury to the people of other States in which it may do business—but here comes another question, and that is, why is it not possible for each state to formulate laws that will protect its own people against Foreign Corporations?

This matter is occupying the best legal minds of the country, and there is no doubt that some decision will be arrived at, that will solve the difficulty on an equitable and fair basis, my remarks being more in the nature of a query, than an expression of opinion, and it may lead you to take greater interest in the subject.

A bill introduced in Pennsylvania Legislature at this session and now in the hands of the Judiciary Special Committee is as follows:

AN ACT.

Requiring the certification of a Certified Public Accountant of the State of Pennsylvania, as to the correctness of any financial statement issued by any Corporation of this State or by any Foreign Corporation or Corporation of other States, doing business in the State of

Pennsylvania, for public information or for purposes of taxation, and to provide a punishment for the violation of this act.

SECTION 1. Be it enacted by the Senate and House of Representatives of the Commonwealth of Pennsylvania in General Assembly met and it is hereby enacted by the authority of the same. That all Corporations of the State of Pennsylvania or Foreign Corporations or Corporations of other States, doing business in the State of Pennsylvania, upon issuing any financial statement inviting the purchase of their Stock or Bonds, or in issuing any monthly, quarterly, semi-annual or annual statements of the condition or business of such Corporations, or any financial statements given to the newspapers, financial agencies, or other financial statements for the purpose of public information in the State of Pennsylvania or upon furnishing statements to the officials of the State of Pennsylvania for the purpose of taxation, shall be required to have such statements verified by a Certified Public Accountant of the State of Pennsylvania.

SEC. 2. If any such Corporation fails to have such certification made it shall be deemed and held guilty of a misdemeanor and upon conviction thereof shall be fined not more than one thousand dollars, nor less than five hundred dollars, and any officer, agent or employee of such Corporation furnishing a false statement or any Certified Public Accountant certifying to the correctness of a statement issued by any Corporation, when it is vitally incorrect or misleading, the officer, agent or employee making such false statement and the Certified Public Accountant certifying to such false statement, shall be deemed guilty of a misdemeanor and on conviction thereof shall be sentenced to imprisonment for a term not exceeding two years and not less than one year, or a fine not exceeding five thousand dollars, nor less than three thousand dollars, or both.

This Act to go into effect on January 1, 1906.

A State act of this kind, although, from first reading, appearing drastic in its requirements, and which, probably will not receive favorable consideration, seems more in the line of fair supervision of a Corporation.

It must be remembered that a Corporation consists of a number of individuals joined together by law, to carry on a certain business, with a limited liability specified by the number of shares held by each individual, and that a partnership is the same thing to all intents and purposes as far as business is concerned, with this exception, and that is that the interest of each partner is specified in the partnership papers, and that each partner's liability covers all of his assets.

In a Corporation a board of directors elected by a majority of the Stockholders is authorized to conduct its business—while each partner as a rule attends to the business of a co-partnership.

No one will dispute the right of a partner to full information as to the conduct of the business in which he is interested, and why should there be any question as to the right of a Stockholder of a Corporation to have the same information as to the workings of the Company of which he is a partner?

The *majority* Stockholders of a Corporation can get any information they may desire, but it is an unfortunate fact that *minority* Stockholders are at a great disadvantage in this matter.

If this be true the *minority* Stockholders of a Corporation should be protected by legislation.

You must not forget that the board of directors of a Corporation are placed in the management of its affairs by a majority of the Stockholders and if, in their judgment, it is not wise to have an examination of their affairs, or information given, their decision is final.

It is true that the practice of having examinations of Corporations made by Certified Public Accountants is gaining ground, but as a rule these examinations, so called, are merely audits by cheap clerks, for the purpose of finding any embezzlement among clerks, and touch very rarely on vital matters, and while we cannot but think that these audits are good as far as they go, yet we do not think, if all Corporations would have examinations made as to operations of the board of directors, it would be to the advantage of all the Stockholders, yet we have shown no reason for the passage of such an act as that now before the Pennsylvania Legislature except for the benefit of minority stockholders.

I say very frankly that were this point taken care of, I can see no reason for further legislation than to cover this point, as long as the Corporations attend strictly to their own business among themselves, unless you will provide the same kind of legislation for other partnerships, *but when a Corporation by its advertisements, by its financial statements asks for investment from the public on account of its published standing*, proper legislation is certainly needed, to prevent the public from being intentionally or unintentionally misled—and it certainly would seem sensible and proper business acumen on the part of officials of the State, that the reports made by officers of a Corporation for the purpose of taxation, should have some other verification than the parties who are to be gainers in reduced taxes, by incorrectness in reports.

Common rumor, while not entitled as a rule to much credence, does say that certain agents of Foreign Corporations are very valuable to them on this one point alone.

Did it ever occur to you that a merchant when advertising his wares, always gives you a chance to examine them, and convince yourself that they are as represented.

Apply the same principle to a Corpora-

tion's Stock and Bonds, and what information can you obtain other than the assertions of an interested party.

I have mentioned incidentally the value of an examination by a Certified Public Accountant.

On the broad principle that a Trustee should at all times be ready to give an accounting of his Trust—and with the well-known fact that presidents, cashiers, directors and officials of every description are but mortals—and of the business principle that an agent should be held to strict accountability—would it not be good policy for the board of Directors to have such examinations made, and if they decline to do so, why should not the Stockholders insist on such examinations for their own safety?

I will not go into the necessity of protection from *fake Corporations*, as the necessity for legislation on that class of Corporations is self-evident, but how are you going to provide for supervision of one without the other.

I think I have covered the reasons for the proposed legislation.

NOW A FEW WORDS AS TO THE PRACTICABILITY OF THE BILL.

One of the objections to the bill, made by some Certified Public Accountants is, that it *will work a hardship on Corporations*, and another is that there are not enough Certified Public Accountants in Pennsylvania to do the work required, consequently the Board of Examiners of Public Accountants, *will have great pressure brought on them, to pass undeserving and unworthy persons*.

We will pass the plea for the Corporations, as they are perfectly able to state their own objections in a much better manner than the Accountants can do, and come to the question of the scarcity of Accountants.

Does not that objection seem to show an

inability to grasp the meaning of the bill? Would it not have shown a broader mind to have asked:

Is the bill right?

Is it needed?

Is it a policy at this time to pass such a measure, *instead of objecting to the bill because, forsooth*, the tools to carry out the provisions of the bill are not sharp enough, and there are not enough of them, to do the work, and that the State Board of Examiners will be compelled to pass undeserving and unworthy men, so as to get enough tools to do the work?

It is the first case that ever came under my observation, where the tools to be used complained of their work, and it is unique in that respect.

As to the scarcity of Certified Public Accountants, I would only say that your Class promises to overcome that objection in the near future, and I am satisfied that the Board will not be compelled to admit undeserving and unworthy men as long as your University has the matter of education in charge.

There may be another reason for the objections of some Certified Public Accountants to the bill, and that is a failure to realize the scope of the bill, as far as the certification of the correctness of a financial statement.

If the certification requires an audit of every account of every Corporation, a checking up of every detail, no wonder they were aghast at the enormity of the work.

It would probably take all the Accountants with all their assistants years to examine the Pennsylvania Railroad alone, if that is their view of the requirements of the bill.

However, I have taken up too much of your time on this subject, and will only say that if such a good thing was to happen as the passage of this bill, I do not anticipate that there will be much difficulty on account

of scarcity of tools, and my experience of Accountants is that they soon adapt themselves to a situation, and are sharp enough to overcome seemingly unsurmountable obstacles.

It just occurs to me that my subject for this address is "Watered Stock" and my remarks have drifted into accounting matters, but as you are deeply interested in these matters, as shown by your attendance in these classes, I will not apologize for straying from the subject but will refresh your mind as to the points I have endeavored to make clear, and hope that I have not led you to think that I am an apologist of fake Corporations.

The points I wish you to think over and which I have endeavored to show in the practical relations of business are these:

First.—That the term "Watered Stock" is a misnomer, and that the issuance of promoter's stock in payment of services, is a legitimate business transaction of the same character as any other business transaction.

Second.—That there is no Watered Stock in fake Companies, the proper name being "SWINDLES" pure and simple.

Third.—That the issuance of Stock and Bonds carrying fixed charges exceeding the income of the Corporation is overcapitalization and must result in disaster.

Fourth.—That Corporations are as liable to business failures as individual enterprises.

Fifth.—That it is as necessary to exercise the same care in the purchase of Stocks or Bonds as you do in the purchase of any other commodity.

Sixth.—That, if you purchase Stock, *on faith*, and you are disappointed in results, do not blame the "other fellow" and cry "Watered Stock" but take your medicine like a man.

Seventh.—That capitalization is not *the* important matter in a Corporation—but that *earnings* determine value.

Eighth.—That Stock quotations do not affect the value of a business and that stock gamblers are entitled to no consideration, as their interest is only in the rise and fall of stocks.

Ninth.—Keep out of the Stock Exchange when the money giants are fighting, they know their business, and you do not, and you are sure to get hurt.

And now in conclusion, a few words, on your choice of a profession, and I use the word profession with a full understanding of its meaning and requirements.

It has been my good fortune to be in at the birth of the profession, to labor year in and year out for its recognition as a profession and to-day in its young manhood—recognized by the law—and by institutions of learning like your great University—I feel very proud of the small part I have taken in furthering its interests.

To you, who are just on the threshold seeking admission, I would say that you have chosen wisely, and I do not think that any other profession gives greater opportunities for brainy men.

Like all other professions, the top is hard to reach—the climb difficult—but a strong steady effort—the exercise of brains—a firm adherence to truth in all your reports—will win for you the respect of your clients. You may have temptations that try your mettle—but let me say to you that an Accountant who yields to his client, not only loses that client in matters where honest statements are needed, but such transactions *will not down*, but are constantly rising to damn you.

The future is bright, very bright for Accountancy, and I wish you all the greatest success both in your examination for admittance into the profession and in your after life. I sincerely thank Dr. Meade and the faculty for the privilege of addressing you, and thank you for your kind attention.

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JUNE, 1905.

Articles appearing in THE AUDITOR are not to be read as having received the endorsement of the society, but are to be taken as individual expressions of opinion, and as such may be answered in future issues. The Editor invites contributions from all Accountants.

Rapidly the profession is gaining ground, as shown by the recognition accorded it by those whom it will benefit. As an instance, we note with pleasure the remarks of James G. Cannon, Vice-President of the Fourth National Bank of New York, before the New Jersey Bankers' Association. Speaking of customers asking credit from a bank, he recommends "the establishment of the custom of requiring statements of financial condition to bear joint certificates of a certified public accountant and of an engineer, as to valuation of cash assets, of merchandise assets, of plant, as to liabilities, net worth, gross business, past results of business and future prospects.

"The certified public accountant has come into prominence in the last ten years and his profession has the guarantee of law in most states of the Union. He concerns himself with the books of account, and records and statements prepared by him have the support of such books, and the banker has the sense of security due to the disinterested and impartial nature of the accountant's position. He may be called the referee in accountancy and the expert on cash valuations."

Coming from a man who enjoys an enviable reputation in the financial world,

these words should have great weight with the banking fraternity.

The revelations contained in the report of Insurance Commissioner Hendricks in regard to the Equitable Life Insurance Company suggest several thoughts. It looks a little strange that the official should have been able to discover all the wrongdoings, about which he is so emphatic, after the company's affairs had been discussed at length in the public press, and yet was unable (or unwilling) to see anything irregular at any of the periodic investigations previously made by his department. The question naturally arises as to how many more boards of directors, whether of insurance companies, banks or any other corporations, are enjoying the profits of subsidiary companies at the expense of the one of which they are the trustees. And, finally, it would be interesting to know whether the employment of independent certified public accountants with authority to probe fully into all the conditions would not have prevented the continuance of the disgraceful state of affairs by the publicity that would have resulted.

It begins to appear as if the Illinois Association of Public Accountants had been wise in barring from membership accountants who were affiliated with audit companies, as they did under their first set of by-laws. Since the amendment was passed admitting them to fellowship in the Association and its successor, the present society, only one such person has taken any interest in the society beyond the payment of dues, and that one has since severed his connection with the audit company to which he belongs. Every courtesy has been extended to these gentlemen by the society and they have been urged to attend its meetings, but they have almost

completely ignored the organization and have almost unanimously neglected to attend its meetings, leaving to the unincorporated members the whole management of the society. Possibly they are satisfied with the management as it exists, but it would seem to require no great exertion on their part to attend an occasional meeting and participate in the discussions.

ACCOUNTANTS MEET

The annual meeting of the Maryland Association of Certified Public Accountants was held in the Fidelity building, Baltimore city, Tuesday evening, June 15, 1905, when the following officers were elected: President, Thomas L. Berry; Vice-President, F. L. Brauns; Secretary, Charles O. Hall; Treasurer, Charles L. Hehl; Auditor, Alfred Atkinson.

Board of Trustees consists of the above-named officers and Karl L. Lee, Carl V. Starkloff, Max Teichmann and Col. John A. Tompkins.

Delegates to the National body are Charles O. Hall and Charles L. Hehl; alternates, Clarence R. Evans and John Kuchler.

Among those present at the meeting were Alfred Atkinson, Thomas L. Berry, Frank Blacklock, F. L. Brauns, L. V. Faller, Eugene Greenway, Charles O. Hall, Charles L. Hehl, Karl L. Lee, C. V. Starkloff.

After an informal discussion of matters pertaining to the profession, the meeting adjourned. Next meeting will be held September 12.

At the meeting of the Wisconsin Bankers' Association, to be held at Ashland, Wis., July 12 and 13, Seymour Walton of the firm of Walton, Roberts & Co., Chicago, is expected to deliver an address treating of bank defalcations and the advantage of employing public accountants in preventing them.

A PROBLEM

The following problem in interest has been submitted to us by a member of the C. P. A. Society. We invite solutions and will publish the names of the successful solvers together with the answers.

Eight notes of even dates aggregating \$215,100.00 mature as follows:

viz:—	
23,175.00	in 4 months from date
34,650.00	in 10 months from date
23,175.00	in 16 months from date.
31,950.00	in 22 months from date.
23,175.00	in 28 months from date.
29,250.00	in 34 months from date.
23,175.00	in 40 months from date.
26,550.00	in 46 months from date.

\$215,100.00

These notes are to be sold to various parties for a net aggregate sum of \$190,000.00, leaving to the investors, \$25,100.00 of profit.

Required, the purchase price to be paid for each note according to its time, and amount, in order that a uniform rate of semi-annual interest on the investment may be realized by all the purchasers.

Computation to be made as of the date of the paper, and for even months, days of grace being ignored.

Mr. William C. Foster, whose remarks on "County Accounts" appear in this number of the Auditor, is exceptionally well qualified to speak on the subject. As assistant tax commissioner of the Chicago & Northwestern Railway Company he has been thrown into close relations with the financial officers in a large number of the counties through which his road passes and has thus gained an extensive acquaintance with their methods. As he is himself an accountant of no mean ability, he is able to appreciate the situation and to offer intelligent advice as to the best remedy for its defects.

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No. 5.

THE PROFESSION OF THE PUBLIC ACCOUNTANT

A LECTURE DELIVERED TO THE EVENING SCHOOL OF ACCOUNTS AND FINANCE OF THE UNIVERSITY OF PENNSYLVANIA ON MONDAY, MARCH 10TH

BY ARTHUR LOWES DICKINSON, M. A., F. C. A., C. P. A.

(Concluded from June issue.)

New Jersey alone contains a reciprocal clause providing for the issue of a New Jersey certificate to the holder of a certificate from another state, practicing in the former state, provided the latter offers reciprocal privileges and requires an equally high qualification for the degree. This gives New Jersey the control of all certified public accountants (from whatever state originating) who practice in New Jersey, and is a step in advance of any preceding act. But to protect the profession and the public from unauthorized and inefficient practitioners, a compulsory registration of all existing accountants in each state is required, with an added provision that hereafter no one may practice as a public accountant (with a wide definition of that term), unless he is so registered. The requirements for registration should be the passing of an examination equivalent to that of the degree of certified public accountant, and not less than three years' experience in the office of a public accountant. These requirements are so moderate that they should meet with little opposition; they are in the interest of the public as much as of the profession, and in this way only can the manufacture of spurious qualification be prevented.

Of equal or even greater importance than

the institution of the degree of certified public accountant is the machinery through which members of the profession in different parts of the country are brought together for their mutual benefit. Reference has already been made to the American Association of Public Accountants, incorporated in 1887 as a national body of practicing accountants. With the creation of the C. P. A. degree in New York state, the demand arose for separate societies in each state, primarily to obtain a similar act there, but also for the interchange of ideas between local accountants and the general furtherance of the objects of the profession. In 1902 there were in existence seven such societies in the states of New York, Pennsylvania, Maryland, Illinois, Massachusetts, New Jersey and Michigan, the members of the first three being limited to certified public accountants of those states, while the other societies whose states had then no C. P. A. law, admitted to their fellow class only practicing public accountants.

The American Association admitted its members from all parts of the country, but there was no connection, and, in fact, in some cases friction, between it and the various state societies; and it had gradually become in effect a local New York society, with a scattering of members in other states, but governed and controlled entirely by

New York accountants. Feeling the need of some central organization, the seven state societies mentioned above held a joint meeting in the autumn of 1902, the result of which was the formation of a central body to which all these societies, except New Jersey, became affiliated. Between this new body and the older American Association it was natural that there should be some rivalry, but fortunately both bodies recognized that their duties to the profession as a whole were of greater importance than the purely local or sentimental interests of any one body, and after much work and discussion, extending over a period of nearly two years, an agreement has now been reached for an amalgamation of these two bodies, retaining the name and charter of the American Association and perpetuating its traditions as the oldest society of public accountants in the country, but with a new constitution and by-laws, under which the different state societies become members as a whole of the National organization, and are represented on its governing body. While membership in the new National Association is composed mainly of the state societies, whether consisting of certified public accountants or otherwise, the regulations also provide for the admission, as individual members, of practicing public accountants who are not members of state societies, either because there is no society in their state or because that society admits only certified public accountants. This form of organization gives the National body the power to control the whole profession, whether certified or uncertified, and, in fact, paves the way for state and national registration bills, under which the right to practice as a public accountant and to offer services as such to the public for remuneration in any of the branches of business which belong to his profession, would be restricted to those who could satisfy the reasonable standard of qualifications set up by the National body. It will then remain

for the certified public accountant to prove by his work that he is entitled to a recognition superior to that of the public accountant who is not so qualified.

At the present time there are in existence altogether sixteen state societies, including those already mentioned and the new societies recently formed in the states of California, Ohio, Missouri, Minnesota, Washington, Louisiana and Tennessee. By October next it is expected that the new National organization, under the old name and charter of the American Association of Public Accountants, will be fully constituted, and that all the existing state societies will be affiliated therewith.

In October of last year the first congress of public accountants in the United States was held at St. Louis with great success, bringing accountants together from nearly every state in the Union, as well as from Canada, Great Britain and Holland. Several interesting papers were read, views interchanged, and a policy of good-fellowship engendered, which helped the consolidation on National lines, which has since been accomplished. In view of the six thousand accountants in Great Britain and her colonies, it is interesting and instructive to note that the total number to whom invitations to attend the congress were sent was under one thousand; and this included every known practicing accountant, as well as many of their clerks and assistants, and others who held salaries positions with corporations or public bodies.

The future of the profession lies in the hands of its younger members; if they can take up the burden where it is laid down by those who have gone before them, it is certain that its development in the direction of increased usefulness to the community, and as an honorable and remunerative occupation for increasing numbers of educated and properly qualified men, must be rapid. And this leads naturally to a consideration of the training which students should re-

ceive, the qualities which they should cultivate, and the work which they may reasonably expect to take up when they have shown their fitness for it.

EDUCATION:

A thoroughly sound general education is as essential for this profession as for any other, but it should be supplemented as early as possible by a study of certain special subjects. The exact form which this education should take is perhaps more a matter for those who have devoted their time to education generally, but it may not be out of place to refer here shortly to certain subjects, a knowledge of which experience has shown to be particularly useful.

First in importance is mathematics, including particularly Interest and Logarithms, both in theory and practice. There is probably no subject which is better qualified to develop the investigating qualities of mind and the power of getting down to first principles in a complicated question; and, apart from this, a thorough knowledge of Interest calculations, both theoretical and practical, and of Logarithms, by which such calculations and others in connection with Cost Accounts, Percentages, etc., can be easily worked out in a short time, is invaluable in practical work.

The next subject of importance is a general understanding of the fundamental economic laws governing trade and commerce, supply and demand, price fluctuations, the theory of inland and foreign exchanges and other banking transactions, and a general knowledge of the different systems of banking in force in different countries. Then would follow the general principles of commercial law, including therein partnership, corporation and bankruptcy laws, and those relating to Executors, Trustees and Receivers, as well as the general tax laws. But it is important to note that the study of these subjects need not be of the same exhaustive character as is required for the practice of the legal profession; all that is wanted is a

thorough acquaintance with general principles. If these are thoroughly mastered the application thereof to complicated cases may well be left to the practical lawyer, whose relations with the Public Accountant will undoubtedly be more satisfactory if the latter has a sufficient knowledge of legal principles and the method of their application to make him an intelligent client. The Public Accountant must remember that he cannot carry on his own business and practice that of a lawyer as well; one or the other must suffer, and if he intends to practice as the former he should hesitate to advise his clients on purely legal points.

After the above subjects, theoretical and practical bookkeeping will be found a comparatively easy subject, and while it is important to thoroughly understand the few simple principles involved in the theory, the practical part of the subject will probably be best learned by actual experience rather than by theoretical training.

Another subject of great value is the theory of life insurance, and a general knowledge of the methods adopted in the valuation of contingencies depending on human life.

Finally, inasmuch as it is practically impossible to remember everything, the object of the student should be to familiarize himself with all the general principles involved in these various subjects, and to know exactly where to look for any deeper knowledge which is necessary.

The School of Commerce and Accounts established in Pennsylvania and in New York, and under consideration in other States, are now furnishing just this kind of education to a greater degree than has been previously attempted in connection with the accounting profession in other countries. The Scottish Societies of Chartered Accountants incorporate in their examinations the elements of actuarial science and general interest and life insurance calculations; and the accounting as well as the legal

subjects are also well covered in both the English and Scottish examinations. But it is an exception to find combined with this even the most elementary knowledge of Banking, Foreign Exchanges or Political Economy, and it is particularly in this direction that the scheme of accounting education in those countries is weak.

Moreover, it is not enough to know that the requisite education can be obtained by those who take the trouble, unless at the same time there is some guarantee that those who are admitted to practice as Certified Public or Chartered Accountants, have availed themselves of it, and to this end it would seem desirable that either the examinations at present required for those degrees should be extended to cover these extra subjects, or that a satisfactory certificate of having passed through such a course of study and the accompanying examinations at one of the recognized University Schools of Commerce should be insisted upon as a preliminary to the final examination for the Accountant's degree. Unfortunately, at the present time a comparatively small percentage of practicing Accountants could satisfy the requirements here suggested; but it is not too much hope that the work of the Schools of Commerce, and the high standard which they are setting, may, with the assistance of members of the profession, and by the further education of the general public as to the position which the Public Accountant should take in commercial economy, gradually increase the standard of efficiency required. It may further be hoped that in the next generation the training suggested above may, by the laws of the various States, and possibly by charter from the Federal Government, be made compulsory for all who are licensed to follow the profession.

The education suggested above, however, must be regarded as preliminary only, and as merely equipping the would-be Public Accountant with the machinery which is

necessary for the successful practice of his profession, and he must still learn how to use the machinery. The practical training which should follow this preliminary work is of the utmost importance, because it is here that the theoretical principles which will form the subject of the earlier education can be seen in their application to the actualities of business and, what is perhaps more important, the danger of an erroneous application of principles is brought home to the student in the disastrous results either to himself or his clients which may follow his errors. There is no little detail in office routine or management which is too small to be thoroughly mastered. The student with such an education as that described above may think himself too learned and important for such small matters, but unless he is prepared to go in at the bottom and learn with the office boy how to index letter books, file papers and write the simplest kind of business letters, he will never be really fitted to take charge of more important affairs. All this must be learned at some time, and if it is not thoroughly mastered at the earliest stages it may be found an expensive and costly matter to acquire the same knowledge by later experience. These elementary details accompanied by the work of checking over books, adding up columns of figures (which alone requires considerable experience to insure accuracy in the shortest possible time), the ruling and preparation of forms of account, and the extraction of general information from the books of accounts, all under the immediate supervision of his superiors, is the earliest stage through which he must pass. Neatness and accuracy displayed during this period, and ability to grasp quickly the fundamental principles involved, will soon result in promotion to more responsible work, such as taking up a whole department of any investigation under the instructions of the senior in

charge, possibly with one or more juniors to supervise. Success in accountancy, as in other affairs, depends on the ability in the Senior to form a correct judgment of the capacity of his assistants, and while keeping them strictly to the limits set for them and insisting upon hard and steady work, at the same time handling them in such a way that they can feel they are not merely machines, but are learning and getting their training as he received his. This is an important stage in the formation of character, and success under all the varying tests to which he is submitted means further advancement. He should have learned two important factors of success in his profession, viz.: that the ability to so instruct others that they can obtain any information desired in a useful form, is quite as valuable as the ability to obtain it himself; and that an even more important quality than either is the power to impart in a clear and concise form to others the results of his own or his assistant's investigations.

The preparation, for submission to the Senior in charge, of full reports on the departmental investigations which he has been conducting, will be a test of his ability and progress as well as a valuable training in the form of report and the systematic arrangement of the subject matter.

Having qualified satisfactorily up to this stage, he will now be entrusted with the entire charge of simple audits and investigations, reporting thereon direct to the Managers or Principles; in the first instance working perhaps by himself, or with one assistant, and afterwards, as he shows his aptitude and has proved that he could be trusted, he would be given more important work with a larger number of assistants under his charge. So, in time, he would work his way up to the position of a manager, in which he would have to supervise a number of different pieces of work at the same time, giving instructions to the senior

assistants in charge thereof as to the points to which they should direct their attention, and the manner in which the work should be mapped out and conducted; and finally revising their reports for submission to the General Managers or Partners. In every one of these stages the importance of neatness, clearness, and accuracy in the papers prepared is of the utmost importance, and is essential to the attainment of a high position in his profession.

A consideration of the theoretical and practical education outlined above shows more clearly the importance of a second qualifying examination for the degree of Certified Public Accountant to be passed after the applicant has been through a course of not less than three years of practical experience in the manner described above. The full certificate given as a result of such qualification, both by practice and by examination, would be an ample guarantee of the fitness of the would-be Accountant to be entrusted with the important duties which he professes himself competent to carry out.

NATURE OF WORK:

A short reference may now be made to the nature of those duties and to the qualities and standard of ethics which are necessary, if they are to be performed for the benefit of the community.

First and foremost, the Public Accountant is the general business adviser of his clients on all questions connected with accounts, and this involves, in most cases, a thorough investigation thereof. Such investigations may be summarized as follows:

First—The investigation of the accounts of a business concern prior to the investment of Capital therein by a purchaser, for the purpose of ascertaining its true financial position and certifying to its earnings.

Secondly—The annual audit of the accounts on behalf of the Stockholders or Directors to insure the accuracy of the

statements of earnings, and to protect the Stockholders against errors of principle therein, as well as against frauds, defalcations and clerical errors.

Thirdly—The investigation of accounts for the purpose of reorganization or consolidation, or for any other purpose for which accurate results independently verified may be required.

Fourthly—The preparation of accounts of Executors, Administrators, Trustees and Receivers in Bankruptcy, with special reference to the form in which they should be submitted to the Court, beneficiaries or creditors.

Fifthly—The devising and installation of modern systems of bookkeeping and cost accounting suitable to the needs of the business with special reference to the preparation of comparative summaries of costs and profit at regular intervals.

It is often claimed that the Public Accountant cannot be as familiar with any particular business as are those who are continuously engaged therein, and that, therefore, his recommendations are of little practical value. Such statements can only be made by those who are either entirely ignorant of his work and qualifications in practice, or whose experience had been limited to one of these so-called Accountants who have never risen beyond the mere book-keeper. Assuming that the Public Accountant has worked at his profession and has risen to a high position therein, it is clear that his experience and knowledge of business affairs in general, and of the forms and systems of accounts which can be adopted therein with advantage to the managers and owners, is far greater than that of officials whose entire experience has been limited to one particular kind of business; who have never seen any other way of doing things than that in force therein, and whose training has not been such as to render it easy for them to adapt the best points of other systems to its uses. All Public

Accountants of experience will agree that they have seldom been called in to investigate or examine the accounts of a business organization, even when the details thereof were entirely unknown to them before they commenced their work, without being able to recommend improvements in the systems of accounting, and frequently in the methods of organizing and conducting the business, which have saved time and money to their clients many times the value of the fee which they have received. This is particularly true in the case of such industries as banking, insurance, railways, etc., where certain stereotyped form and methods have been in use for a number of years, and have been carried on from one official to another, and the Accounting Departments have frequently been entirely in the hands of men who have had no experience outside of that particular industry, and therefore no opportunity of introducing new methods except on the same old lines. The Public Accountant, from his training and experience, is enabled in a few hours to make himself familiar with the main underlying principles in which one class of industry differs from another, and it is this very fact which renders his work most useful to his clients. There is a tendency nowadays towards specialization: one man will hold himself out as especially expert in Bank Accounts, another as especially expert in Railroads, and so on; and the public have not yet realized that the very fact that these men have converted themselves into specialists in these particular industries has deprived them of a great part of their value to their clients. The inefficiency of the Federal and State Bank examinations is well recognized, and leading Bank Examiners have, from time to time, strongly recommended an independent audit of bank accounts as an added protection to the Stockholders and Depositors. Experience shows that the independent examination, where carried out by a thoroughly qualified Public Accountant,

is strong just where the Official examination is weak, but if the independent accountant is merely an official bank examiner in private practice instead of Government service, what more can be expected than the more or less inefficient examination which is at present in force. It is in the application of general business principles, both of organization and accounting, to any particular business, that the value of the Public Accountant to his client largely depends.

It is clear that, for the purpose of adequately performing his various duties for the benefit of his clients, the Public Accountant requires qualities of the highest character. He must have considerable ability, absolute integrity, must be entirely free to act on his own responsibility, untrammelled by any interests either of his own or of others, that might in any way bias his judgment; he should not allow himself to be placed in a position in which his remuneration may in any way depend upon the favorable or unfavorable results which his reports may show, nor should it depend upon the carrying through of a financial operation the success or failure of which might be materially affected by any bias shown in his report. He must also be absolutely secret, not only as to the results of his investigation, but as to the work he is doing, secrecy in both being frequently of vital importance to his clients.

Up to the present time the place of the Public Accountant in the industrial development of the country has hardly been recognized, his duties and responsibilities have been largely confined to particular clients, and he has not been called upon, to any extent, to undertake those wider responsibilities to the general public, which in England and Scotland have for many years formed a large part of his practice. In those countries it has for a quarter of a century been the custom to have the accounts of all public corporations audited

at least once a year, and generally by Chartered Accountants, elected each year by the Stockholders and reporting to them. In a condition prevails, but this is the exception limited number of cases in America the same rather than the rule. Such audits are usually carried out for the Directors. If the Directors can be persuaded that the views of the Accountants are correct, they will adopt them, and the Balance Sheet may bear the Accountant's certificate to its accuracy. In the contrary case, the Directors will receive the Accountant's recommendations, will not adopt them, will prepare the accounts in their own way and submit them to their Stockholders with no certificate, and while the fact of a disagreement between the Directors and Accountants, in which the probability is that the Directors are wrong, is of considerable importance to the Stockholders (the latter have no means whatever of obtaining any information on the subject. The regulation of large corporations doing an interstate business is now the question of the hour, and there can be no doubt whatever that one great step towards its solution would be the compulsory publication to the Stockholders, at least once a year, of Balance Sheets and Income Statements certified by thoroughly responsible Public Accountants appointed by the Stockholders with full power to report to them, independently of any control by the Directors. It is in this direction that the future development of the Accountancy profession lies at the moment.

If the scheme of education and training outlined above can be made a necessary qualification, there must gradually grow up a higher average standard of professional attainments than at present exists. The public will thus, by degrees, learn that there exists a class of professional men who can be thoroughly relied upon as competent business advisers on all questions connected with finance and accounts, and whose standing in the community for ability, integrity,

independence of judgment, and responsibility, peculiarly fits them to fill the position of Receivers, Trustees, Arbitrators, or, in fact, any other position in the world of commerce for which such qualities are the first essential.

This is the standard for which the profession to-day is striving, and in aid of which these Schools of Commerce and Finance have great possibilities. The work they are doing is on the right lines, and is training up just the right class of men. If the profession will maintain and add to the

high ideals it has at present, if these schools will spread throughout the country and send their best members to the ranks of the profession, determined each to take his share in its progressive development, there can be no doubt that the Public Accountants of the rising generation will attain, as a class, to a position in the community at least equal to the highest at the present time, and that the profession will afford an honorable and remunerative career for all those who adopt it as their life work.

ERRORS OF PRINCIPLE.

SEYMOUR WALTON, C. P. A.

(Concluded from June issue.)

In the meantime the supposed profit on the transactions had been covered into profit and loss account when the books were closed, and a false credit to that account had been created amounting to thousands of dollars. The only proper way to keep such accounts is to credit consignment sales and charge the consignee in a special consignment account.

A similar error is found in the usual treatment of goods sold on the instalment plan, especially where the credit extends over a long period, as in the case of pianos. It is customary to credit sales and charge the purchaser with the full price of the goods, thus giving the month and the year in which they are sold the full benefit of the profit, and leaving to subsequent periods the expense of collecting the instalments. Dicksee pays particular attention to this subject, but treats the deferred payments only from the standpoint of the loss of interest on the capital tied up. He says: "The best principle is to regard the difference between the cash price and the credit price of the articles sold as in-

terest charged, and having ascertained the average rate of interest to apportion it between the three years over which the currency of these agreements almost invariably runs." In this country the time is usually limited to two years, and the deferred payments usually carry interest. As a rule no attempt is made to equalize the profits over the time in this country, the whole profit being taken by the year in which the sale originates, largely because of the difficulty of keeping an accurate account of a very large number of cases. It might be done with sufficient accuracy by keeping an entirely separate set of accounts with the instalment goods, an instalment goods purchase account, an instalment sales account, and instalment customers' accounts and by closing out of these at the end of the fiscal period only the proportion for which payment had actually been received. That is, the instalment department would buy the goods from the main business and would account for the profits on those goods only which had been actually paid for.

A curious error in principle that is often

found consists in the manner of treating bad debts. It is a very common thing to find these charged to a suspense account which is still carried on the books as an asset and therefore is included in the profits. Many a business man prides himself on his conservatism in promptly charged past due accounts to suspense and it is very difficult sometimes to show him that he has done nothing more than to change the name of the account and has not in any way altered its nature as an asset, unless he has at the same time opened a contingent reserve account on the other side of the ledger.

Inventories are a frequent source of error, and it is difficult sometimes to say just what are errors in this connection, as good authorities are not entirely agreed on all the points involved. The best authorities seem to unite in saying that nothing should be valued at a higher figure than its actual cost. The cost will include all the elements, direct and indirect, that have so far entered into the production of the finished goods or those in process of completion. The practice of listing finished articles at the selling price, less the supposed cost of selling, is common, but cannot be depended upon unless some way is found to guarantee the future market price and also the selling conditions. The cost of selling for previous years is not always a safe criterion for the coming months. With a given number of salesmen on the road, or a given running expense in the store, the comparative selling cost varies to a certain extent with the volume of business done, so that a diminished trade would increase the selling cost and impose an additional burden on the current year that may be already showing bad results, owing to the reduction in gross profits.

A practice that may lead to serious error, but which is frequently defended by manufacturers who indulge in it, consists in inventorying raw material at the

market price when that is greater than the actual cost. It is claimed that the advance in price is a legitimate profit of the year in which it occurred, and the profit and loss account is given credit for it while it remains as only a possible profit, in case the market does not react before the material is made up and sold. The broad principle should be adopted that no profit can be depended upon until the goods are actually sold, and that in the meantime the material should be carried at not more than cost. On the other hand, when the market price of the raw material has dropped since its purchase, the conservative man will carry it at the lower price in the inventory. In other words, the advice usually given by the careful auditor is to carry the material at whichever price is the lower. If this is a mistake it is certainly one on the safe side, and if there are any surprises in store for the man who follows it, they will prove to be pleasant ones, while the other course may lead to consequences that will be disagreeable if not disastrous.

A curious lapse was observed not long ago in an office which may be called an error of principle, since it involved a complete ignoring of the fundamental principle. The auditor had instituted the usual check upon the man who was both bookkeeper and cashier by causing the manager to have listed by his stenographer all the remittances received by mail, to which were to be added the office collections, as shown by the duplicate register slip and the total compared with the bank deposit slip and the entry in the pass-book. The manager was very careful to have the list made every day, but it was not even added up, let alone compared with the bank deposit.

Referring again to the question of a reserve account, we find that it is frequently confounded with a sinking fund. The latter, however, has nothing to do with the profit and loss account when the

fund is established to take care of bonds or other debts at their maturity. In this case the payments to the sinking funds consists simply in a change of assets which are intended eventually to cancel a liability. When, however, the fund is established to take up a wasting asset, such as a lease interest, it is a charge against earnings, because the diminishing value of the leasehold is an expense of the business and the fund that takes care of it must be derived from profits, in the same way that profits have to cover any other item of expense.

A question that involves a very important principle is that of the right to carry a secret reserve. This usually consists of the undervaluation of assets for the purpose of reducing the profits at a time when they are large in order to increase them again when they may have fallen off.

At the time when the defalcation of \$690,000 in the First National Bank of New York was discovered it was stated by the officers of the bank that the entire amount could be taken up without charging any of it to the undivided profit account. A great many persons were unable to understand how this could be done, and only a few were any wiser when they were told that the bank had a large secret reserve.

It appears that the practice of accumulating secret reserves is a growing one and that it is by no means confined to banks, and it is very warmly defended by those who practice it. They claim that it is better to conceal abnormally large profits one year so as to provide against the necessity of showing unusual losses in another year. In the case of a close corporation or partnership, whose stockholders or members know all about the business, there would be no serious objection, but there would also be no special reason for doing it. It would then be about on a par with the practice of the

suburbanite who sets his watch five minutes fast so that he may be sure to catch his train. In the case of a company whose stock is somewhat scattered, and may be sold at any time on the basis of the statements furnished to the stockholders, it seems impossible to find any justification for the practice. The seller of such stock is unquestionably defrauded out of the increased price that he could have obtained if the true conditions had been known to him and to the buyer. If the buyer happens to be one of those on the inside, with knowledge of the secret reserve, while the seller is ignorant of it, the injustice to the latter is still more flagrant. In the case of the bank mentioned the one item referred to amounted to 14 per cent of the total capital. All sales made prior to the discovery of the shortage were based on wrong assumptions to the detriment of the sellers.

It is not probable that anyone would defend the managing partner of an ordinary co-partnership if he deliberately understated the profits, so as to prevent his partners from drawing out a greater dividend than he thought proper. But the president and directors of a corporation are simply the managers of a partnership affair, the act of incorporation being for the purpose of limiting the liability, and, for greater convenience of action, but not in any other way causing the company to differ from an ordinary partnership.

The auditor who is acting for the stockholders of a company would not seem to be justified in signing a certificate to a statement which contains a secret reserve, or any other element that is not exactly in accordance with the facts. Not only is he bound to tell all the truth for truth's sake, but he is also under obligations to give all the stockholders all the information in his power. Those auditors who take a different view of this question defend their course on the ground that they

are employed by the president and directors of the company and are not supposed to criticise their management of the business. While it is true that it would be better to follow the English plan and have the auditors appointed by the stockholders as their special representatives, it does not seem clear that the appointment by the directors absolves the auditor from his duty to the stockholders. Although not made directly to them, his report is to be used with the stockholders and it should be as carefully prepared as if made originally to them, and should contain nothing which would cause any stockholder to make an incorrect declaration as to the true condition of the company.

An error that is often made in incorporated companies consists in the way in which so-called treasury stock is handled. It is not an uncommon thing to issue all the stock of a company to someone in payment of a patent, copyright, secret formula or other property of such nature, or for a mining claim. As the value of the thing thus bought is left to the judgment of the board of directors, their vote to accept it in payment of the stock makes the latter full paid. In order to give the company working capital the party who receives it donates a portion of it back to the company. The stock thus donated is put into the treasury of the company and is sold to provide funds to develop the business. But as this stock is almost always sold at a discount, it is an error to put it in the treasury, at least in this state, because when the company thus obtains possession of it, the particular stock that was paid up by the original transaction is extinguished, and when the company sells the stock out of its treasury it is in effect issuing new or original stock to take the place of that which has been canceled. Everybody knows that when original stock is bought direct from a company for less than its face, the purchaser is liable for

the difference between what he paid and par, so that every one of the companies who have sold that kind of stock in this state have left their stockholders liable to an assessment. The proper way to treat it is to have the donated stock put in the name of some individual as trustee for the donor, in which case the equity existing in the donor is carried to the trustee and there is no liability, for the sale is made from the stock that was paid up by the original transaction.

A curious error occurred in a building and loan association which was being wound up. The stockholders had voted to liquidate by declaring dividends on the free stock only until 60 per cent had been paid and then to pay dividends on all the stock alike. The dividends were paid as fast as 10 per cent was accumulated, but the secretary calculated the 10 per cent in each case on the remaining balances, that is, on an original balance of \$100.00, the first dividend was \$10.00; the second, based on the balance of \$90.00 then remaining, was \$9.00, the third \$8.10, and so on. Fortunately for him, the error was discovered before he had paid the sixth 10 per cent dividend, or he would have begun paying off the pledged stock on the supposition that six 10 per cent dividends made 60 per cent, instead of what it really was, about 47 per cent. He was convinced of his error only when he was shown that ten of his 10 per cent dividends amounted to only a trifle over 65 per cent, and that after he had thus paid out 100 per cent of the original \$100.00, according to his method, he would still have \$34.87 to pay.

These examples of some of the errors that are noticed by an auditor are sufficient to show that he has much more important work to perform in examining the accounts of a business house than the finding out whether the petty cash may not be short a few cents or even the general cash be shy several hundreds.

HENRY CLEWS ON THE PUBLIC ACCOUNTANT

In an extremely interesting address before the Minnesota Bankers' Association, Mr. Clews gave his opinion of the value of the Certified Public Accountant in no uncertain terms. We regret that we have not the space to give the address in full, for Mr. Clews is always worth listening to. But we must content ourselves with the following comparatively brief extracts:

Of many improvements that might be well introduced into our commercial practice, the one of primary significance is the adoption of intelligent methods of accounting and auditing by all corporations or associations of persons which employ a considerable capital. The time has certainly arrived when the old and familiar systems of "bookkeeping" will no longer fittingly and advantageously answer for the conduct of modern financial business. It is now impossible for the manager of any large business to oversee in person its various operations and details. Results must be reduced to a scientific basis; they must be classified with the same minute care that a scientist would devote to the arrangement of a series of plants belonging to a new family or genus. This need for reform and for scientific method is not confined to any one group of institutions or any particular species of business enterprise. It is a general, if not universal, need, resulting from the great growth of our activities, both in their scope and in the amount of capital they involve. Nor is it confined to private enterprise. It extends also to municipal governments, which, influenced in part by the work on accounting which is being done by the census office, are casting about for ways by which they may reorganize their business and statistical methods.

It will not, however, be sufficient for our business men merely to revise their

methods along the lines indicated. There must be added a system of publicity of accounts which shall convey to the investor in a sincere and unmistakable way every business detail that he has any right to know.

The successful carrying out of these ideas will imply the co-operation of skilful public accountants and auditors equipped with that thorough knowledge of economic principles which will enable them to formulate systems of classification, and show not merely the financial condition of a given business at a stated time, but the commercial facts upon which its affairs rest and on which its future prospects of success must depend. Such a body of experts is already in existence, though the number of competent men is, perhaps, small, and far from being well distributed throughout the country. The men available are, however, increasing in number and their profession is gaining in respect and consideration. We have a number of chartered accountants of Scotland and England who have served the minimum apprenticeship of five years and have passed the rigid examinations in general accounting, commercial and bankruptcy law and actuarial science which are required before their diplomas of "C. A." are accorded to them. In at least four states we have now distinct legal recognition of the accountant as a professional man, the standard being set by the state of New York in its Public Accountants Act, which grants the title C. P. A. to all such as pass a specified examination. This example should be followed by other states. It would be well if these laws required the serving of a five years' apprenticeship before applicants could graduate.

In banking we find no exception to the general backwardness of method of which

I have been speaking; and as our bankers are the leaders in commercial thought, other members of the business community can hardly be expected to be more progressive. Says ex-Secretary Gage: "It is a strange anomaly that while in nearly every other department of life, improvement is the indispensable rule, in the field of banking finance and exchange, we go on with an indifferent regard to the handicap imposed by defective methods." These words, though uttered some time ago, have been given unexpected and special significance by recent unfortunate happenings, on which I need not dwell, but which indicate the need of radical changes in bank examinations as well as in the relations of our banks with their customers and correspondents.

The fact that many of our business men, even those who are leaders of thought in their own communities, continue to employ antiquated methods in the conduct of their business and still depend upon out-of-date forms of statement, entails grave danger to the credit basis of the community. And this danger is greater because those who are the cause of it have no intention to deceive. Some, when they become involved, purposely resort to misleading methods of statement, or even wilfully misrepresent the state of their affairs. But these are the exceptions. The truth is that this is more than a question of personal honesty and honor. It involves the commercial soundness of the community, and every effort should be employed to ascertain facts, and make sure that the statements submitted by applicants for credit correctly represent the state of the business to which they relate. Our practice has, in this regard, been far too lax; and a long step toward sounder conditions would be taken were our bank managers to require the certification of the balance sheets of borrowers by competent public account-

ants. Such a plan is followed in European countries with most satisfactory results.

It is obvious that all banking within its own sphere, whether local, national or international, should be as good as the best. If examinations are inadequate, we should see that they are made rigorous; if doubt exists as to the value of a borrower's assets, or of the security offered, we should clear it up by demanding statements as to the condition of the borrower, or the value of his collaterals, made upon scientific lines and guaranteed by expert inspection and certification, or refuse accommodation. This is the plan now rapidly coming into vogue among large New York institutions, and there is no reason why it should not be adopted throughout the country.

IN WASHINGTON

The following are the questions set up for the C. P. A. examination for the state of Washington on June 15 and 16, 1905:

THEORY OF ACCOUNTS.

TIME ALLOWED, THREE HOURS.

1. What do you understand by the terms:
 - (a) Fixed (or Permanent) Assets?
 - (b) Floating (or Quick) Assets?
 Name three examples of each.
2. Define
 - (a) Reserve Account,
 - (b) Reserve Fund,
 - (c) Sinking Fund,
 and state, in connection with each, whether it is an Asset or a Liability.
3. Define
 - (a) Bookkeeping,
 - (b) Accounting,
 - (c) Auditing,
 and show the relations of each to the others.
4. How would you ascertain the profits of a firm whose books are kept by single entry?

5. What is the object of Cost Accounts? State the principal items of expense which go to make up the factory cost of a finished product.
6. What do you understand by the term "Secret Reserve?" Name two ways in which such a Reserve may be created, and suggest a purpose for its creation.
7. You are asked to advise whether a Company working a wasting property (e. g. a mine) should, before the annual closing of its books, make any provision for the estimated depreciation of such property, or whether it should be allowed to stand on the books at its original figure without any such provision being made. State your opinion, giving reasons.
8. Give headings for a combined Cash Book and Journal, and state what you consider to be the advantages (if any) and disadvantages (if any) of such a book.
9. Give headings for a Voucher Record Book suitable to any business with which you are acquainted. State briefly some advantages (if any) and disadvantages (if any) of the Voucher System.
10. Without using figures, outline a Balance Sheet for a Manufacturing Corporation, and state how you would treat each of the following items:—
 - (a) Depreciation of Plant.
 - (b) Interest payable accrued.
 - (c) Unexpired Insurance.
 - (d) Provisions for Bad and Doubtful Accounts Receivable.
11. Describe the Merchandise Account as it is generally kept. Show how it may be subdivided, and the advantages (if any) of such subdivision.
12. (a) Define "Goodwill." (b) On what basis should Goodwill be valued? (c) On what grounds (if any) can an

increase in the book value of Goodwill be justified?

PRACTICAL ACCOUNTING.

TIME ALLOWED, FOUR HOURS.

1. A Mining Company is organized with a Capital Stock of \$100,000 in Shares of \$1 each. The entire Capital Stock is issued in payment for the properties acquired by the Company. The Stockholders then return to the Company, as a gift, 25,000 Shares, which are to be sold by the Company for the purpose of providing working capital. The Company afterwards sells 10,000 of these Shares at 50c each, and the remainder at 75c each.
Prepare Journal entries covering these transactions.
2. The directors of a Manufacturing Company, before closing the books for the half year ending June 30, 1905, declare a dividend for the half year of 3 per cent. on the Preferred Stock and 2 per cent. on the Common Stock. There was brought forward from last year an undivided profit balance of \$15,000. Trial balance June 30, 1905, is as follows:

DEBIT BALANCES:—

Real Estate and Buildings, \$65,000; Discount and Interest, \$1,500; Book Debts, \$84,000; Salaries (General), \$22,000; Trade Discounts and Allowances, \$12,500; Stock on hand December 31, 1904, \$58,000; Plant and Machinery, \$80,000; Management Salaries, \$10,000; Preferred Stock in Treasury, \$10,000; Labor, \$176,000; Patents and Goodwill, \$160,000; Investments, \$31,000; General Expenses, \$8,600; Cash in Bank, \$16,000; Freight, \$3,000; Repairs, \$2,000; Insurance, \$1,750; Fuel, \$12,000; Purchases, \$165,000.

CREDIT BALANCES:—

Bills Payable, \$52,000; Profit and Loss Account, \$8,000; Common Stock, \$200,000; Sales, \$438,350; Accounts Payable, \$20,000; Preferred Stock, \$200,000.

The Stock on hand June 30, 1905, is \$55,000. Compile Profit and Loss Account and Balance Sheet at June 30, 1905, providing for depreciation at 7½ per cent. per annum on Plant and Machinery, and a reserve of 5 per cent. on book debts to provide for bad and doubtful accounts; also create a liability for the dividend as stated above.

3. Jones & Brown, partners, decided to incorporate on December 31, 1904. At that date their Balance Sheet was as follows:

ASSETS:—

Real Estate and Improvements	\$25,000	\$
Bills and Accounts Receivable	30,000	
Inventory	20,000	
Cash	2,500	77,500
		<hr/>

LIABILITIES:—

Bills and Accounts Payable	\$33,500	
Jones, Capital Account	22,000	
Brown, Capital Account	22,000	77,500
		<hr/>

A Corporation (The Jones-Brown Co.) was organized with a Capital Stock of \$100,000, and entered into an agreement with Jones & Brown whereby it was to take over all the assets, and assume all the liability on Bills and Accounts Payable, at the above figures, except that the Real Estate and Improvements were to be taken over at \$35,000, and that \$26,-

000 was to be paid Jones & Brown for the Goodwill of the business. The entire payment to Jones & Brown was to be made as to \$5,000 in Cash and \$80,000 in Stock.

Cash subscriptions for Stock were received as follows:

From Smith	\$ 5,000
From Robinson	10,000
From Jenkins	5,000

Prepare (1) Journal Entries of the above transactions for the books of the Corporation, assuming that the Capital Stock has been issued as stated; (2) Balance Sheet of the Corporation after making the entries, and (3) Journal entries to close the books of the Jones & Brown partnership

4. A & B purchased the Assets and took over the Liabilities of a business for which they paid \$40,000, each providing \$20,000. The price was made up as follows:

Real Estate	\$17,500
Plant and Machinery	10,250
Stock of Merchandise	\$15,000
Accounts Receivable	11,920
	<hr/>

Total Assets

LESS:—

Accounts Payable...	\$13,250
Allowance for discounts and bad debts	1,420
	<hr/>

Purchase money paid in Cash..\$40,000

A & B agreed to admit C into partnership, on the terms that they first added to the price paid \$4,000 for Goodwill, and that C brought in a sum in Cash sufficient to make him an equal partner. C paid the necessary sum to a Partnership Account at the Bank.

Make the opening entries in the journal of the new firm, recording the

above transactions, and draw up a Balance Sheet as at the commencement of A, B and C's partnership, assuming that all the Capital had been brought in before there was any change in the Assets or Liabilities.

5. A fire occurred in the factory of a firm, and the following sums were recovered from the Insurance Companies:

For loss on Buildings.....	\$ 4,000
Machinery	6,500
Merchandise	10,000
	—————
	\$20,500

The firm spent, in restoring them to their original condition, \$4,750 on the buildings and \$6,000 on the Machinery. They also spent, in cleaning and sundries incidental to the fire, \$100.

The firm's valuation of the Merchandise lost and damaged was \$11,600. After the fire \$1,000 was realized from the sale of damaged Stock.

Prepare Journal entries to show how the above matters should be dealt with on the firm's books.

6. On May 31, 1905, Corporation A sells its Assets (except Cash) to Corporation B. The Balance Sheet of Corporation A is as follows:

ASSETS:—

Real Estate, Buildings, Machinery and Furniture....	\$40,000
Merchandise Inventory	15,000
Bills and Accounts Receivable	20,000
Cash	5,000
	—————
	\$80,000

LIABILITIES:—

Capital Stock—500	
Shares of \$100...	\$50,000
Bills and Accounts Payable	25,000
Undivided Profits..	5,000
	—————
	80,000

The selling price to Corporation B is \$100,000; \$50,000 being payable in Cash and \$50,000 in the Capital Stock of Corporation B.

On completion of the sale to Corporation B, Corporation A pays its Bills and Accounts Payable, distributes the Assets then remaining to its Stockholders pro rata and dissolves.

Prepare journal entries for Corporation A, covering the above transactions and closing out Corporation A's books. Also state how much (a) in Cash, (b) in Stock of Corporation B each Share of Corporation A is entitled to in the final distribution.

7. Following is a list of the Accounts appearing on the Trial Balance of a Manufacturing Company which deals in finished Merchandise purchased as well as in its own products. From this list, and without using figures, draw up plans of Financial Statements (Balance Sheet, Manufacturing Account, Profit and Loss Account, etc.), in the form which you think most suitable:—

Accounts Payable.
Capital Stock.
Bills Receivable.
Cash.
Salaries, Management.
Bills Payable.
Salaries, Office and Store.
Real Estate.
Fuel.
Insurance (Plant).
Light.
Freight (on M'dse purchased).
Machinery and Tools.
Freight (on Raw Materials).
Buildings.
Sales (own products).
Inventory (own products).
Inventory, Raw Materials.
Inventory partly Manufactured Goods.

Inventory Merchandise purchased.
 Inventory Repair Supplies.
 Sales (Merchandise purchased).
 Undivided Profits (end of last year).
 Purchases (Merchandise).
 Rent, Factory.
 Rent, Store and Office.
 Printing and Stationery.
 Accounts Receivable.
 Advertising.
 Purchases (Raw Materials).
 Machinery Repairs.
 Productive Labor (Factory).
 Labor (Warehouse).
 Office Furniture.
 Reserve for Bad and Doubtful Accounts.
 Reserve for Depreciation.
 Insurance (Merchandise).
 Bad and Doubtful Accounts.
 Travelers' Expenses and Salaries.
 Management Salary, Office.
 Management Salary, Factory.
 Discounts allowed.
 Interest payable.
 Depreciation.
 Goodwill.
 Sundry Factory Expenses.
 Sundry Office Expenses.
 Postage.
 Subscriptions and Donations.
 Discount Received.
 Rents (Receivable).
 Insurance unexpired—Plant.
 Insurance unexpired—Merchandise.

8. Idle & Stretch, merchants, are unable to meet their obligations. From their books, papers and information the following particulars relative to their affairs are ascertained:

Cash on hand\$ 250
 Accounts Receivable: Good,
 \$1,250; Doubtful, \$600 (estimated to produce \$200);
 Bad, \$1,000 2,850
 Real Estate 14,000

Bills Receivable (good).... 4,250
 Idle, Drawing Account.... 9,000
 Stretch, Drawing Account.. 8,400
 Sundry Losses on Trading.. 13,500
 Trade Expenses 7,400
 Creditors—Unsecured 25,000
 Partly secured... 23,900
 Fully secured.... 17,000
 Securities: \$5,000 in hand;
 \$11,000 pledged with partly
 secured Creditors; and balance
 pledged to fully secured
 Creditors 33,000
 Preferential Claims for
 Wages 750
 Idle, Capital 10,000
 Stretch, Capital 16,000
 Prepare (a) a Statement of Affairs
 showing the Assets and Liabilities
 with respect to their realization and
 liquidation; and (b) a Deficiency Account
 in respect of the deficiency shown
 by the Statement of Affairs.

AUDITING.

Time Allowed, Three Hours.

1. What is an Auditor's duty in connection with the verification of
 - (a) Merchandise Inventory.
 - (b) Accounts Receivable.
 - (c) Investments.
 - (d) Cash.
2. Outline the work to be done in the audit of a Bank.
3. In auditing the books of a Magazine Publisher you find that he has on hand Contracts amounting to \$50,000 for advertising space in his Magazine, \$20,000 of which are unfilled or uncompleted at the close of the fiscal period. The cost of obtaining the Contracts is estimated at 15 per cent. of the amount thereof.

State what in your opinion is the correct way of dealing with the Contracts and the contracting Expenses

in the Financial Statements for the period.

4. In the Machinery Account of a firm whose books you are auditing appear charges for
 - (a) New parts to replace old ones worn out.
 - (b) Engineer's salary.
 - (c) Labor setting up New Machinery.
 - (d) Moving old machinery from one part of the factory and setting it up in another.

Do you see any, and if so what, objection to these charges being so treated?

5. What constitutes Capital Expenditure? Would you, as Auditor, be justified in certifying to the accuracy of Accounts in which such expenditure appeared without making enquiry into the real character?
6. You are called upon to audit the books of a Corporation which has on its Customers Ledgers a very large number of Accounts. In the General Ledger are carried Customers Ledger Controlling Accounts.

What steps would you think it sufficient to take in order to verify the individual balances on the Customers Ledgers?

7. A Syndicate is to purchase a certain Manufacturing business and to take over all its Accounts Receivable and Payable as on May 31, 1905. A Statement of the Assets and Liabilities on that date is submitted by the Vendors to the Syndicate, and this Statement you are instructed by the Syndicate to verify by an examination of the books.

Controlling Accounts are carried in the General Ledger for "Accounts

Receivable" and "Accounts Payable."

State briefly how you would proceed with your examination, and to what points you would give special attention, it being understood that you are not expected to make a detailed audit.

8. A Gas Company, of which you are Auditor, laid down fifteen years ago a main costing \$37,500, which remained undisturbed until the present year, when one-half of it was replaced by a larger one costing \$31,500. An extra main was laid alongside the other half of the original one (which remains in use) at a cost of \$21,000.

You are asked to advise how much of the items of \$31,500 and \$21,000 should be charged to Capital Expenditure.

In your answer do not take into account the question of depreciation.

9. What special points in the Balance Sheet of a Corporation—apart from the correctness of figures—do you consider need careful consideration to afford due protection to Directors and Auditors?
10. Outline a plan for the audit of any business with which you are acquainted.
11. The Real Estate holdings of a Manufacturing Corporation of which you are Auditor have substantially increased in value since their purchase. The Directors have caused the Real Estate Account on the books to be debited and Profit and Loss Account credited with the amount of the increased value.

Do you consider this procedure justified? State reasons for your answer.

12. Criticise the following Balance Sheet:

ASSETS:—

Machinery, at cost.....	\$70,000.00
Buildings, at cost	20,000.00
Goodwill	25,000.00
Formation Expenses	3,000.00
Inventory:	
Raw Material, at cost	\$10,000.00
Merchandise in process of Manufacture, at cost....	10,000,000
Merchandise, finished, at selling price	23,000,000
Bills Receivable, face value..	3,500.00
Accounts Receivable, face value	22,000.00
Cash	2,500.00
	<hr/>
	\$189,000.00

LIABILITIES:

Capital Stock	\$100,000.00
Bills Payable	50,000.00
Accounts Payable ..	30,000.00
Undivided Profits ..	9,000.00
	<hr/>
	\$189,000.00

COMMERCIAL LAW.

Time Allowed, Two Hours.

1. Under what circumstances may the court appoint a Receiver for a Corporation?
2. (a) What is the legal rate of interest in the State of Washington?
(b) What exceptions (if any) are permitted?
3. Define
(a) Arbitration.
(b) Demurrage.
(c) Escrow.
4. Define
(a) Principal.
(b) Agent.
(c) Assignee.
5. (a) How is a Corporation formed?
(b) How is a Corporation dissolved?
6. (a) To what extent is a Stockholder liable for the debts of his Corporation?
(b) Are there any circumstances under which a Corporation may issue its Stock at a discount?

7. Draw Promissory Notes as follows:
(a) Non-negotiable.
(b) Negotiable.
8. Define
(a) Partnership.
(b) Preferred Stock.
(c) Common Stock.
9. A Promissory note, made for the purpose of the Puyallup Shipbuilding Co., is signed as follows:
"JOHN SIWASH,
"Treasurer Puyallup Shipbuilding Co."
Who is liable on the note?
10. (a) Define Special Partner.
(b) What are the rights and responsibilities of a Special Partner?
11. Define
(a) Bottomry Bond.
(b) Bailment.
(c) Chattel Mortgage.
12. What are the liabilities of the signers of the following note: (a) to the holder (b) as between themselves:—
\$3,500.
"Steilacoom, Wash., May 3, 1905.
"Sixty days after date we promise to pay to the order of Peter Simple Thirty-five hundred dollars at Ninety-third National Bank, value received.
"A. B.
"C. D.
"E. F."

SOME ANSWERS.

Below I send you my solution of the problem in interest in your issue of June, 1905:

Face Value.	Mos.	Discount.	Present Worth.
\$23,175.00	4	\$ 438.63	\$22,736.37
34,650.00	10	1,639.55	33,010.45
23,175.00	16	1,754.53	21,420.47
31,950.00	22	3,325.94	28,624.06
23,175.00	28	3,070.43	20,104.57
29,250.00	34	4,705.72	24,544.28
23,175.00	40	4,386.33	18,788.67
26,550.00	46	5,778.87	20,771.13
<hr/>		<hr/>	<hr/>
\$215,100.00		\$25,100.00	\$190,000.00

Chicago. Yours truly,
E. A. TALBOT.

Taking any certain rate of interest, using the same rate for each note, I find the present worth of each note.

Finding the difference between the aggregate present worth of all the notes and \$190,000.00, the selling price, I divide this difference among the notes in proportion to their present worth, and find the selling price of each note to be:

1st	\$22,882.88
2nd	33,165.90
3rd	21,481.89
4th	28,650.07
5th	20,080.89
6th	24,460.70
7th	18,679.90
8th	20,597.77
	<hr/>
	\$190,000.00

WORK

Face.		Present Worth.
23,175.00	discounted 4mo @ 6%	22,711.50
34,650.00	10	32,917.50
23,175.00	16	21,321.00
31,950.00	22	28,435.50
23,175.00	28	19,930.50
29,250.00	34	24,277.50
23,175.00	40	18,540.00
26,550.00	46	20,443.50
		<hr/>
		188,577.00

Selling price...\$190,000.00

Present worth.. 188,577.00

\$ 1,423.00 proportioned to the different notes according to their present worths, and this amount added to the respective present worths gives the selling prices of the eight notes as at the top of the page.

Yours truly,

Rhineland, Wis. M. GERMOND.

PENNSYLVANIA ENTERPRISE

We copy the following sensible suggestions from the June number of the Business World of New York:

“STATEMENTS SHOULD BE CERTIFIED BY
C. P. A.’S.

“In his address on ‘Credits,’ before the New Jersey State Bankers’ convention, in March of this year, Mr. James G. Can-

non, vice-president of the Fourth National Bank of New York, strongly advocated all banks requiring borrowers to furnish statements certified to by C. P. A.’s.

“The importance of this matter to the Certified Public Accountants can scarcely be overestimated, and the Pennsylvania Institute of Certified Public Accountants, ever awake to the interests of the profession, have had his address published in pamphlet form and are sending it out broadcast among the business houses of that state, with the references to C. P. A.’s printed in bold-faced type. Such action is bound to result in good to all members of the profession, and we hope that similar action will be taken by state societies of Public Accountants and Certified Public Accountants wherever such exist in the United States. Were such action to result in the requirement of such certified statements in but one per cent. of the cases where credit is required from the banks of this country, the enormous increase in the field of work for the public accountant would demand not only the entire services of all now engaged in the work, but it would provide employment for a long time to come for all the young blood that the state boards of examiners are semi-annually admitting to practice.

“Best of all the resultant good to the banker, the general commercial and mercantile world would more than pay for the increased labor. Last but not least in importance is the fact that such a requirement would prevent many defalcations, fraudulent failures and protect the honest but ignorant merchant who now borrows till he can borrow no more, and then calls in the aid of the bankruptcy court. By all means help in this good work, which not only leads to immediate material benefit to all but also tends toward greater honesty, better methods and higher morality in the business world.”

THE AUDITOR

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JULY, 1905.

Articles appearing in THE AUDITOR are not to be read as having received the endorsement of the society, but are to be taken as individual expressions of opinion, and as such may be answered in future issues. The Editor invites contributions from all Accountants.

The Chicago Banker in a recent issue discusses the question of the examinations of National Banks. It makes a number of statements that should interest accountants as well as bankers, among others that: "It seems to be practically admitted that the examinations which the comptroller is authorized to make are not very effective as measures for preventing violations of the law."

Of special importance to our profession is its treatment of the alternative of the examination by the outside public accountant. "The private auditor is often a delusion and a snare. One of the loose-leaf manufacturing concerns also proposes to audit banks and furnish new systems. It is reported that many of these 'experts' are only city salesmen at \$65 to \$70 per month, sent out at \$25 per day and expenses to gull the country bank and sell supplies. This is a fraud."

We are glad to see that this excellent journal is able to discriminate between the stationery seller and the true accountant, but it strikes us that our various so-

cieties should take the matter up in a serious way and try to educate the public as to the true standing of the Certified Public Accountant and the difference between him and the irresponsible "expert," whether employed by the stationery house or practicing on his own account. If the title C. P. A. is to be of any value it can be made so only by emphasizing the difference in the minds of the business world, the only place where the distinction can be of any real worth to the profession.

Evidently the banks are beginning to take notice. In addition to the remarks quoted in our last issue, we find the following reference to the profession in an address delivered before the Pennsylvania Bankers' Association by Mr. George M. Coffin, vice-president of the Phenix National Bank of New York. Speaking of the official examination and the necessity for more thorough investigations, he says: "One proof of my contention is that some of the largest banks in the country, examined twice a year by the government, have special examinations made by Certified Public Accountants for which they pay four and five times as much as they pay for the government examination. Were they satisfied with the official examinations they certainly would not incur the expense of the others."

In another column we give extracts from an address by that veteran of finance, Henry Clews, before the Minnesota bankers, in which he dwells at considerable length on the advantage of the accountant to the banker.

When such authorities as these are so emphatic in the endorsement of the profession, it would seem as if the field thus opened up were well worth cultivating. We commend the subject to the attention of the various societies of Certified Public Accountants in the country.

CORPORATION SYSTEM

BY CHARLES A. HONECKER.

Progress made in accounting in comparison with the existing conditions a very few years ago is surprising. Corporations, during the same period, have multiplied, and have consolidated many industries under one management, either under one gigantic corporation or by control through majority of stock holdings in other companies. This advancement has been made possible, to a large extent, on account of development in accounting systems and general practice, which has kept abreast, and in many cases in advance, of the times, otherwise these great consolidations would not have met with the success they have. Investigation into the cause of failure of so many corporations will show that a large percentage is directly attributed to incomplete accounting systems, so that at the present time our great financial institutions and capitalists are giving a greater degree of attention to the equipment of the accounting departments of concerns they are interested in than ever before.

It is of the utmost importance that the officers of corporations be acquainted with the company's condition as often as possible. With a business of large proportions, many checks are necessary to cover the various operations, as the possibilities of leakage or waste in numerous channels will cause considerable loss unless the greatest vigilance in the accounting department is exercised.

It is admitted that corporation officials, managers and superintendents are not all experienced accountants, but being men of recognized ability in their respective business capacities are able to detect the weak points, and must of necessity depend upon the accounting department for prompt statements, containing accurate information that will assist them in finding a

remedy. A system that fails to respond with prompt and accurate statements at any moment will have a tendency to shortly get the company's affairs in a serious state, and has often proved disastrous.

Therefore, before attempting to introduce a change, every move must be carefully considered, and upon completion of all forms, it should be worked out to see that everything is covered and connected. Failure in successfully installing a system is often due to many who attempt to partially install it with the object of experimenting, causing considerable trouble before satisfactory results are obtained.

To endeavor to cover these various departments in detail would be beyond the scope of this paper, but I will in a brief manner consider the following general departments:

General Bookkeeping, Ledgers, Accounts Receivable, Invoicing, Journals, Vouchers Audited, Cash Book, Cost Department, Filing.

To work systematically is to work successfully. Method is the essential element on which every solid and substantial concern is based. There is no doubt that the subject of corporation Systems has been neglected to a large extent. We are working on old systems which have served their day and generation. Systems which have had their day, but, unfortunately, have not ceased to be; for a mere glance at many of them will prove that no method is used and that concern moves under conditions that are disgraceful; the wonder is how it moves at all. It is not entirely the want of brains, it is not the difficulty of working out a vast and complicated scheme, it is not a matter of involving the company in a large outlay of money, it is simply a question of system. A perfect organization is an essential and vital

element in securing success in whatever form of institution we may wish to carry on.

It is almost as difficult to persuade those who have the responsibility of conducting large corporations that a complete and intelligent office organization will save money, time and worry as it was a few years ago to convince them that the use of modern machine tools was indispensable to good workmanship with cheap production. To expect this to be carried out with old-fashioned books and foolscap paper would be equivalent to expecting the production of a high-class engine by old-fashioned appliances, at the same price, and within the same time as one turned out by the aid of the latest labor-saving machinery. It is useless to subdivide labor if the workman be not supplied with the latest machine for executing his particular part of the whole, and it would be equally useless subdividing the labor in the office if the latest books and forms, all designed and printed to serve a particular purpose, were not adopted. A clerk can turn out accurate work when he has only to fill in specially prepared forms on specially prepared books. Strictly speaking, the old-fashioned, cumbersome double-entry system, with its ledger, day book, journal and cash book, which contains a maze of bewildering and puzzling entries, that none but well trained accountants can successfully deal with, is already being elbowed out by the modern systems, under which ordinary clerks are employed for the mere collection of details, while the summarizing of results is left for the experienced auditor.

THE NEW YORK SOCIETY

At a meeting of the New York State Society of Certified Public Accountants, held at the Waldorf Astoria Hotel, New York city, on Monday evening, June 12, 1905, it was unanimously resolved to

make application for membership on behalf of the New York State Society in the American Association of Public Accountants under the new constitution and by-laws adopted at the last annual meeting.

The full quota of delegates was elected as follows:

E. W. Sells, chairman; Leonard H. Conant, Duncan MacInnes, Thomas P. Ryan, C. E. LeJeune, Henry R. M. Cook, Francis Howe, Edward L. Suffern, Samuel D. Patterson, Wood S. Loudoun.

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Boughey, Frank M.....	Partner	Menzies, Robertson & Co.....	Chicago.
Buchanan, Robert S.....	Individual practice..	R. S. Buchanan.....	Chicago.
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Ring, Richard F.....	In special practice..	Richard F. Ring.....	Louisville
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Wilmot, H. W.....	Partner	Jones, Cæsar, Dickinson, Wilmot & Co...	New York.
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Seatree, W. Ernest.....	Manager	Jones, Cæsar, Dickinson, Wilmot & Co...	New York.
Junior—			
Cullen, W. H.....	Assistant with.....	John Alex. Cooper.....	Chicago.

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Chicago, Ill., August, 1905.

No. 6.

TREASURY STOCK.

By William H. Emrich of the Chicago Bar.

The term "stock" as applied to corporations ordinarily means certificates of stock which are merely evidences of proportions of the assets of the corporation.

They are not credits in the sense of notes or bills, nor are they money or representatives thereof.

The "capital stock" is the sum total of the property represented by all of the certificates. Its title is in the corporate entity. It is managed and controlled by the board of directors only so far as to carrying on the general purpose of the business, unless special power is expressly delegated to the directors as a body.

Certificates of stock are not negotiable instruments, the law governing notes and bills does not apply and a purchaser takes the certificates subject to existing equities. Innocent purchasers of stolen certificates are not protected, but after a registration of transfer and issue of new certificates the transferee is protected. The gradual tendency, however, because of the universality of this mode of representing values is to apply the law of negotiable instruments, thus assisting in the ease and celerity of conducting business.

The stock certificate with the charter or articles of incorporation and the state statutes constitute the contract of association between the stockholders personally, between the stockholders and the corporation, and between the stockholder and corporation and the creditors.

The division of stocks into classes designated as "common" or "preferred" is determined by their priority in the right to share in dividends out of the earnings of the company; common or deferred being subordinated to the payment of dividends to "preferred" stock. Debenture stock" is in the nature of a "receiver's certificate" and is a mortgage on the earnings.

Because of the custom in the organization of large corporations of securing the services of financial houses or agents and the payment to them of a proportion, commonly 20 per cent, of the total capitalization for services rendered in floating the corporation and known as "promotor's stock" a system has grown up by which a portion of all, with the exception of a few shares as originally subscribed for under the requirements of the various incorporation laws, is returned to the company and held or issued as "treasury stock." This designation is used to distinguish it from promotor's stock, and it is more readily sold because of its use for securing sufficient funds to carry out the purposes of the corporation.

The usual custom in the creation of treasury stock is to issue the majority of the stock to the person or persons organizing the corporation, who pay for the stock in turning over leases, franchises or other licenses or patents or property necessary to the operation of the company, but of largely speculative or at least uncertain

value; the party or parties so receiving this stock which it is pretended is fully paid by the assets turned over, then returns to the treasury of the company a portion or all of the stock, so received and paid for by him, to be sold for the purpose of raising money for the purchase of machinery, construction work and the payment of the operating expenses until the corporation has developed an earning capacity.

The liability of the holder of treasury stock, however, cannot be said to differ from that of any other stockholder, except that treasury stock is commonly bought on the assumption that it has been paid for, issued and returned to the treasury and therefore the purchaser is an innocent purchaser without knowledge as to the amount originally paid, but the courts do not permit such escape from liability and have established the doctrine that the purchaser of treasury stock must ascertain whether the corporation has received the par value of the stock, otherwise he is liable to creditors whether he accepts the stock as a bonus with the purchase of bonds or pays for it some small portion of its face value.

The law applying to stock with reference to the liability of the stockholder and the original subscriber to corporate creditors differs in different states. In some states where stock is issued in exchange for services or property other than money, the valuation placed by the board of directors upon the property received by the corporation is conclusive; in certain other states where the board of directors has acted in good faith and exercised reasonable business discretion, the estimate placed upon the value of the property by the board of directors is accepted. But in other states, including Illinois, under any condition of circumstances, the creditors of the corporation may inquire into the actual value of the assets received in payment for the stock and the stock will be considered paid

only to the extent that the property or labor received bears to the par value of the stock.

Wherever corporations are organized the liability of the holder of certificates of stock, is limited to the par value of such stock, and, when this par value is fully paid in money, property or services the liability is entirely satisfied. The only exception to this is certain banking and trust corporations where the liability by statute for the benefit of creditors is twice the par value of the stock, that is, in case of insolvency, the holders, in addition to the stock being fully paid, are liable to the creditors to the extent of the face value of the stock. But a certificate of stock is not necessary to make one a subscriber and therefore liable. All that is necessary so far as creditors are concerned is that the subscriber shall have bound himself to become a contributor to the fund which the stock of the corporation represents.

The corporation may, however, as between the holders of certificates and itself issue stock at less than par value "as fully paid and non-assessable," and when so issued, the corporation is estopped to issue any calls for payment of balance, and cannot forfeit stock for non-payment.

As to the creditors, however, this is no protection to the stockholders. If the corporation has not in fact received the total par value of the stock, the creditors of the corporation in insolvency may enforce the payment of the portion remaining unpaid and apply it to the satisfaction of creditors.

In the United States, the courts of equity have evolved the doctrine that the capital stock and other property of a corporation constitute a trust fund for the payment of corporate obligations, and that no part of this fund can be lawfully withheld or withdrawn by the stockholders, if there are any outstanding corporate obligations to the payment of which such assets should

be applied. Hence, if any part of the capital stock for which a stockholder has subscribed be unpaid, the amount of such unpaid subscription remains in his hands impressed with a trust in favor of corporate creditors, and if the assets of the corporation are insufficient to discharge its debts a court of equity may, at the instance of creditors, subject the unpaid subscription to their payment, and a stockholder who accepts "bonus stock," issued by a corporation without assets to support it, is liable to creditors.

This liability of stockholders for unpaid subscriptions is founded upon the soundest principles of equity and cannot be avoided by the acquiescence of the corporation in any nominal payment, or by making an untrue recital on the stock certificate that the shares are fully paid.

The stock of mining corporation constitute in some jurisdictions an exception to this principal, because of the universally known custom of such corporations to have a very large nominal capital and to issue such capital to its full amount as paid up, but to dispose of it at what it will bring on the market.

The capital of such corporations from the nature of the venture is of an extremely fluctuating and uncertain character, and is invested in property acquired for the sole purpose of being exhausted and distributed among shareholders in the form of dividend and is not kept as a permanent fund with which to carry on business.

In *Re South Mountain Consol. Min. Co.* 7 Sawy. (U. S.) 30; 14 Fed. Rep., 347.

In England the trust fund doctrine does not obtain. There aside from the statutory provisions, creditors have, in general, no greater rights against subscribers than the company itself has, and the release of subscribers is largely discretionary with the board of directors.

In the case of *Allen vs. Wenzel*, 133 Ill.,

264 (1890), a bill was filed to enforce stockholders' liability on an unsatisfied execution.

Section 8 of the Illinois Corporation Act provides "that each stockholder shall be liable for the debts of the corporation to the extent of the unpaid portion of the stock held by him." And further, "no assignor of stock shall be released from any such indebtedness by reason of any assignment of a stock, but shall remain jointly liable therefor with the assignees until such stock shall be fully paid, and each assignee or transferee shall be liable therefor in the same manner as the original subscriber," and Section 25 provides "that if any corporation or its agents shall * * * allow any execution, after demand made to be returned no property found and to remain unsatisfied for not less than 10 days after such demand, or shall dissolve or cease doing business, having debts unpaid, suits in equity may be brought against all persons who are stockholders at the time or liable in any way for the debts of the corporation by joining the corporation in such suits; and each stockholder may be required to pay his *pro rata* share of such debts or liabilities to the extent of the unpaid portion of his stock, after exhausting the assets of such corporation."

In this case the evidence showed that by a peculiar system of bookkeeping most of the capital stock of the corporation was transferred upon the books of the company to the corporation itself and thereafter called treasury stock; that the company and its officers and stockholders acted upon the supposition that by these entries and transfers the company became the legal holder of that portion of the stock of the company. That the company subsequently transferred the stock as its property to purchasers at less than its par value. That this so-called treasury stock was held by two defendants to the extent of 1,000

shares each, who paid the price fixed by a resolution of the board of directors, i. e., \$10 per share of \$100 par and the courts found that each was liable for the unpaid balance of the par value of such shares.

It was contended that after this transfer of the capital stock to the treasury of the corporation it was held and might be sold as any other property of the company, and that the defendants purchased their stock in good faith, as full-paid stock and that they are not liable to assessment under the statute and that the stock certificates indicated on their face that the stock was fully paid.

The question did not arise between the corporation and the stockholder, but between the insolvent corporation and its creditors, and the court says: The capital stock of a company is a trust fund that the directors may not give away or misappropriate and any device by which members of the corporation seek to avoid the liability imposed by law is void as to creditors whether binding or not as between themselves or between them and the corporation. It is not in the power of the stockholder by private agreement of the corporation to make the shares of stock non-assessible, so as to excuse payment for such stock at its par value as against creditors. Citing,

Melvin vs. Lamar Ins. Co., 80th Ill., 446.

Zirkel vs. Joliet Opera House Co., 79 Ill., 334.

It is clear that each of the parties in procuring stock from the corporation knew that the corporation was not receiving par value therefor. The plan pursued in this case was but a device to evade the law. The amount paid by them will in equity be treated as a payment upon their stock and they will be held liable for their *pro rata* share to the creditors of the insolvent corporation.

They purchased stock and took it of the

company at from one-twentieth to one-fifth of its face value, thereby reducing the capital of the company upon the faith of which the public was authorized to deal with it. The plan pursued was but a device to evade the law and to defeat its useful and wholesome provisions.

The case of Coleman vs. Howe, 154 Ill., 458 (1895), was a bill filed under Section 25 to enforce stockholders' liability against holders of certificates who had bought treasury stock, issued originally in the sum of \$300,000 for property worth about \$75,000, and one-half of which stock was subsequently returned to the company to be held by its trustee for sale to purchasers as fully paid and non-assessable. The corporation was organized with a nominal capital placed at \$300,000, because the earnings of the co-partnership prior to incorporation were \$18,000 per annum, or 6 percent on the capitalization adopted. In the report as commissioners under license to organize a corporation the stock was subscribed for in toto by the three partners; neither paid any money into the treasury but subsequently transferred to the corporation, after one-half of the stock so originally received by them had been assigned to the trustee, the firm property worth not to exceed \$75,000. The corporation also assumed an indebtedness of the old company amounting to \$70,000.

The evidence disclosed the following procedure. The entire capital stock was first issued to the three original subscribers who were the owners of the firm property.

Subsequently assignments were endorsed on the certificates for one-half of the shares to a trustee for the corporation. These certificates were then surrendered to the corporation and three new certificates were issued to the three former partners for stock of the par value of \$150,000 and a new certificate was issued to the trustee for the balance of \$150,000 par value.

This certificate to the trustee was subsequently surrendered and there was issued by the corporation to three new purchasers of stock three certificates of the total par value of \$45,000 for which the company received in cash \$22,500, or 50 percent of their face value and a further certificate was issued to the trustee for the balance of the par value of \$105,000 and delivered to the trustee.

It was understood among all stockholders prior to the incorporation that the stock should be taken at 50 percent of its par value. On trial a decree was entered under which each of the said purchasers of stock were decreed to pay respectively, on account of the unpaid portion of the stock so held, his proportionate share of the liabilities of the corporation.

It was contended on the part of the stockholders that they could not be regarded as original stockholders or original subscribers to stock, but that they had purchased it as fully paid-up stock from the trustee and that they were therefore bona-fide holders.

The Court says:—"A purchaser or assignee of stock which has not been fully paid does not become liable to the corporation creditor, for the unpaid balance where the stock issued has been fully paid and he has acquired the same in good faith and without notice that it has not been fully paid. But where a person purchasing stock issued as fully paid has notice that it has not been fully paid his liability is the same as the person transferring it to him. The doctrine that the capital stock is a trust fund applies not only to original subscribers but to purchasers and assignees with notice. The transaction by which certain parties received stock of the face value of twice the amount actually paid amounts to nothing more than an agreement between them and the corporation that the remaining 50 per cent should not

be called for. Such an agreement cannot be sustained as against creditors. The issue of paid-up shares at less than their par value is a fraud on creditors and the findings of the lower court must be sustained."

In the efforts of the courts to establish a principle giving some protection to corporate creditors it was necessary to modify some of the statements contained in earlier decisions. In a late case where relief was denied to the corporate creditors on the broad statement of the law made in *Coleman vs. Howe* (Supra), that a bona fide purchaser for value and without notice could not be held liable to the corporation or its creditors, the Supreme Court reversed the decisions of the Superior and Appellate courts and enforced the liability of the stockholders.

In this case, *Garden City Sand Company vs. American Refuse Crematory Company*, 205 Ill., 42 (1903), the appellee company was incorporated for \$1,000,000 divided into 10,000 shares of \$100 each for the purpose of operating and dealing in crematory furnaces. One Walker and one Bates subscribed each for one share and one Rutan, the owner of the patents, subscribed for the remainder of the stock of the par value of \$999,800, for which he paid by the assignment to the corporation of certain letters patent issued by the United States Government for an invention in garbage crematories.

The stock was issued as fully paid and non-assessable. Subsequently the corporation became indebted to the appellant and on an execution unsatisfied a bill was filed under the statute to enforce stockholders' liability. The master found that the patents did not exceed in value \$50,500; there was no proof that any of the subsequent stockholders knew of the actual consideration paid to Rutan or that there had been a fraudulent overvaluation or that the patent was not worth the par value of the

stock exchanged for it. The records of the corporation showed some proceedings for raising money with reference to treasury stock but the stubbs in the stock-book showed that the stock of the stockholders, about ten in number other than the original subscribers, was assigned from Rutan.

The court says: "The stock was issued as fully paid and non-assessable, but that fact furnishes to appellees no exemption from liability. Undoubtedly stock may be issued in payment of the purchase price of property sold to a company; in such a case the corporation may agree with the stockholder as to the value of the property but the transaction must constitute a valid contract of bargain and sale in good faith in the exercise of fair and honest judgment. The stockholder is not to be charged with the liability to the creditor of the corporation if he acts in good faith and there are no circumstances to put him on inquiry.

In this case the corporation had a capital of \$1,000,000; stock for all of which except two shares was issued to Rutan. It is not conceivable that a person of ordinary intelligence and prudence buying shares of stock in such a corporation would not become advised as to what property the company had. In fact, some of the appellee stockholders made advances of money to meet expenses. It is clear that the appellees knew that the corporation had no money and no property aside from the patent, and it would not be creditable to them to say that they believed the patent to be worth \$999,800."

In conclusion it may be said that the gradual tendency of the courts especially in this state has been to protect creditors in their dealing with corporations and to compel stockholders to satisfy the obligations incurred by the corporations with whose affairs they should be familiar.

St. Louis, July 29, 1905.
The Auditor, Chicago.
Gentlemen:—Herewith I beg to hand you solution of problem submitted in your June issue by a member of the C. P. A. Society, viz.:

	Present worth or pur- chase price.
\$23,175. 4 months.....	\$ 22,741.18
34,650. 10 " 	33,025.17
23,175. 16 " 	21,432.18
31,950. 22 " 	28,638.12
23,175. 28 " 	20,109.94
29,250. 34 " 	24,540.79
23,175. 40 " 	18,774.61
26,550. 46 " 	20,738.01
Total	\$190,000.00

Yours respectfully,
THEODORE BOTHMANN,
Auditor Mercantile Trust Company.

BANK AUDITS

ADDRESS BEFORE WISCONSIN BANKERS' ASSOCIATION

BY SEYMOUR WALTON, C. P. A., CHICAGO.

As strong as the force of gravitation in the physical universe is the force of habit in the moral and mental world. Men are constantly running into grooves or ruts in all their activities, whether social, religious or business. This is especially true of their business lives, and arises partly from insufficient time, partly from disinclination to exert themselves and very often from lack of knowledge of anything more desirable. While these facts are true of persons engaged in any business, they are especially so in the banking profession. The work of one day is so much like that of another that the tendency to fall into routine habits is almost irresistible, and there seems little or no opportunity for originality. Yet there are few places where originality is more needed and where a proper use of brains is more valuable than behind the counter of a bank. The great difficulty in most banks, especially in the large cities, is that the banker is so constantly occupied that he has no time to develop any ideas if he has the foundation for them. He is too busy to study the details of the bank's business in such a way as to discover the evidences of irregularities, even when they would seem to have been very apparent, judged in the light of after events, or to make the proper deductions in regard to the real condition of its customers, even if he knows that a careful scrutiny of their accounts will often reveal very interesting facts. For instance, he does not take the trouble to ascertain the relations between a customer's total yearly sales and the amount of his bank movement during the same time. Yet there is no more valuable

information in regard to a borrowing customer than the fact, if it exists, that his total deposits, excluding his single name paper, are considerably in excess of his total sales. The excess is suspicious, to say the least, as it must consist of items that are of a kiting nature, or otherwise illegitimate. It is far easier for the credit man of the bank to make a few preliminary investigations, accept the customer's own statement of his net worth, grant him a line of credit and then drop quietly and easily into a rut and stay there until he is rudely jostled out of it by a bankruptcy notice.

In the same way, the officers of a bank acquire the habit of implicitly trusting their clerks and their fellow officers. Each one of them, working in his own particular groove, soon becomes satisfied if his own department is correctly handled and pays no attention to anyone else, except when his groove happens to meet or cross that of another. As long as everything is properly adjusted to meet the requirements of his own particular balance, he pays little attention to how the adjustment is effected. In the nature of things, he cannot be expected to concern himself with anything outside of his own department and certainly is not called upon to investigate the intricacies of his neighbor's special province. But it is this very habit of confining each man to his own peculiar rut that offers the opportunity for the misapplication of funds, when temptation assails a man too weak to resist it. Some banks attempt to obviate this difficulty by a constant exchange of duties on the part of their working force. This plan unques-

tionably takes the men out of their grooves and is an absolute preventive of trouble, but it is open to the objection that customers do not like to deal with different persons when they have become accustomed to having their affairs satisfactorily looked after by those who know and respect their various peculiarities. Other institutions have a general clerk or auditor, whose duty it is to check up each department, but the auditor himself is liable to get into a groove and to perform his duties in a perfunctory manner. He is also subject to limitations when the irregularity that he may detect is the work of an officer of the bank, whom he does not dare to criticize unless the fault has already amounted to criminality. The only other protection now employed by the majority of banks is afforded by the infrequent visits of the official examiner, whose time is too limited and whose examination is too superficial to detect any but the most glaring irregularities. As long as the requirements of the banking law as to reserves, the ten per cent limitation on loans and other specific legal demands are satisfactorily met, his duty is fulfilled. Any ordinarily well-covered irregularity is sure to escape his attention, and he should not be blamed if it does. It is the duty of the directors to see that the officers are properly discharging the functions of their respective positions and of the officers to properly supervise the work of the employees. It would be difficult to find a case in banking history where a defalcation would not have been prevented if all the officers had been properly alert in their attention to facts whose significance became apparent after the discovery of the shortage, but which had been overlooked in the hurry of daily work or ignored because the surface routine had not been disturbed by the malign forces at work underneath.

It is hardly fair to blame very seriously the bank officers for their neglect to cover all the points at which an attack may be made on the defenses of the bank against manipulation of the accounts. They have, usually enough to do to protect themselves from assault by outside enemies, the danger from which is more apparent and also more frequent than that from traitors inside their own walls. Constant intercourse with their daily associates makes the idea of any treachery on their part almost an unthinkable proposition. The universal exclamation when the wrong is discovered is: "I would as soon have thought of suspecting myself." It is natural that this condition should exist, and it would be a very unfortunate thing if this mutual confidence and esteem were broken up and each man in a bank were to be an Ishmael with "his hand against every man, and every man's hand against him." Each would feel that his neighbor was a spy, and every little suspicious circumstance would be exaggerated into a crime. Yet between this impossible condition and the indifference which results from the inertia of routine habit, there seems no middle course possible to those inside the walls of the bank.

We are then forced to the conclusion that if any remedy is to be found it must be looked for outside of the bank itself. The present Comptroller of the Currency has already suggested this in his able address to the Illinois Bankers last October in which he said: "In addition to such exhibitions as are made at regular meetings, the directors should have frequent thorough examinations by committees of the board, or experts employed for the purpose. These should be made independently of the active officers of the bank. Every clerk and every officer of the bank should be examined and checked up as thoroughly as possible, and required to

show the examining committee or auditor just how the matters in his charge stand. No man who is in a position of trust has any right to resent such an examination, and one who has a proper appreciation of the relations he bears to those who have reposed trust and confidence in him will welcome such an opportunity to show that he has been faithful and efficient."

With such high authority in favor of the outside auditor, no argument should be needed to demonstrate his value. A word may be said about the auditing committee of the board of directors. In connection with the value of the contents of the portfolio their advice is probably the best obtainable. They are in a position to know the financial condition of their borrowing customers as well as it can be ascertained in any way, except by requiring periodical statements made by an outside trained accountant. But when it comes to the intricacies of the accounts, it is a rare thing to find on the board of any bank a director who is qualified by experience to understand them sufficiently to detect any but the most glaring irregularities.

The ordinary board of directors is composed of busy men who have time to give only the most cursory attention to the affairs of the bank. The officers and clerks have grown up perhaps from boyhood under their eyes, and for many long years have faithfully executed the trusts confided to them. It is no wonder that the directors learn to rely upon them implicitly, even to the extent of refusing to appoint an examining committee when requested to do so by some officer who desires to force them into taking their just share in the responsibility of the active management.

With the directors deep in the rut of absolute confidence in the officers and the officers equally deep in their rut of

perfect reliance on the clerks, it is easy for a designing man to find an opportunity to take advantage of the situation, knowing that he will be secure as long as he does not allow any of his operations to encroach on any one's else particular rut.

In such a condition of affairs, not by any means an uncommon condition, as every banker knows, there would seem to be no possibility of protecting the bank from the unlooked-for traitor by any means now in common use. The profession which I represent asks you to consider the claim of the certified public accountant to be the best person to offer protection to the bank, as he has for years successfully given it to the merchant and manufacturer.

It is only within the last few years that the profession of the public accountant has been brought into prominence, and it is still not as well understood as it should be by those to whom his services are of value. He is a man whose training is entirely along the lines of the scientific investigation of accounts, which is a very different thing from the mere verification of their mechanical accuracy. A number of the states have recognized the new profession by passing laws allowing the title of Certified Public Accountant to be borne only by those who are able, by long experience or by passing a severe examination, to demonstrate their fitness for the work required of them. As their clients are found in all lines of business, they are constantly brought into touch with an infinite variety of accounts, and are therefore in little danger of falling into ruts or grooves, and, being independent of any special influence, they are not liable to favor even the higher officers if there is anything that needs criticism or reform.

Their training teaches them to simplify accounts as far as possible and at the same time to make all the departments of an office fit into each other so as to make a

harmonious whole, each part so closely related to every other that an irregularity in one place will throw the machinery in another out of gear. They may be said to put interlocking switches at the points where one groove crosses another, which will to a certain extent automatically prevent trouble in either.

It is difficult to formulate a universal system applicable to all offices, even in the same line of business, and while banking accounts are as simple as any, no one institution is so precisely like another that it would be safe to say that the same methods would exactly fit all cases. Each individual bank must be studied to ascertain just what its particular needs are, and how best to meet them. And where loose and slipshod habits have been broken up, there must be constant vigilance to prevent their return, or the adoption of equally dangerous new ones. The contention of the public accountants is that the most effective vigilance can be exercised by those who are fitted by their whole training to discover and remedy flaws in method and who approach the task of a periodic audit with minds free from prejudice or bias, and with sufficient time at their disposal to give the subject the attention it deserves.

The saying that each man thinks all men mortal but himself can be paralleled by the virtual certainty that each banker has that his particular office contains none but men of the most sterling integrity. Each one thinks that auditing precautions are excellent for every bank but his own, but is so sure of his own associates that he does not need anything of the kind himself. To the credit of human nature it may be said that he is usually right. The vast majority of men are honest. If it were not so, the record of financial delinquencies would be far longer than it is, for there is no question but that the opportunities for wrongdoing are almost

limitless. The honest man, however, does not object to a proper supervision of his work, and should welcome it as a precaution against the weakness of his own human nature. For nearly every case of shortage is accurately described by the phrase—"a good man gone wrong." It is very seldom a case of deliberate dishonesty. The man is usually a really good man in his intentions and his natural tendencies, but he is weak and unable to stand the temptation that comes in subtle guise when he thinks he sees an absolutely sure way to make considerable sums if he only had sufficient capital to start with. He is so sure of his calculations that he feels justified in temporarily using the funds of others, expecting to return them in a short time, after having caused them to earn a fortune of more or less magnitude for himself. It can never be known how many men have been successful in these calculations and have since returned to the straight and narrow path. We hear only of the failures, and not all of them, for a very considerable proportion are hushed up for fear of the disastrous effects on the credit of the bank.

As a means of justifying the confidence of the general public in the correct management of the bank, it would be a great advantage to have it known that it has adopted the precaution of having a thorough examination made by an unprejudiced and competent accountant. If his certificate, worded in general terms, were exhibited in the public banking room and with it there appeared another certificate signed by a committee of the directors, or, better still, by a committee of stockholders, not officially connected with the bank, that they had examined the discounted paper on hand and considered it good, the confidence engendered by the willingness to submit to this test would probably far more than pay for the ex-

pense of the examination by the additional business it would bring to the bank. This plan would also have a good effect on the directors themselves, who might be prevented from making some questionable loan for fear it would not pass the scrutiny of the committee, and would certainly have a deterrent effect on the conduct of those bank officials whose directors allow

them to have full control of the management of the bank.

The professional accountants of the country commend the subject to the careful attention of the banks, confident that a proper study of the situation will develop plans that will render less frequent the distressing occurrences that have recently shocked the financial world.



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Articles appearing in THE AUDITOR are not to be read as having received the endorsement of the society, but are to be taken as individual expressions of opinion, and as such may be answered in future issues. The Editor invites contributions from all Accountants.

A very significant sign of the times is the frequent mention in trade journals of the advantage of employing certified public accountants. We have called attention recently in these columns to articles appearing in the banking organs showing an unusual interest in this subject. In the last number of the Street Railway Review we note an editorial on the "Value of Verified Publicity," which takes the ground that the proper way to defeat municipal ownership is to give the exact facts in regard to street railway problems, and that the facts must be furnished by some one in whom the public has implicit confidence and not by the officers of the roads themselves. The article concludes with the sentence, "Here is the field for the public accountant, whose profession it is to furnish that valuable commodity which may be called verified publicity."

It seems to us worth while for the accountants to pay particular attention to this very large and promising field for the exercise of their talents.

Mr. William H. Emrich, whose interesting paper on Treasury Stock will be found

in another column, is especially well fitted to speak on the subject, not only on account of his standing at the bar, but because he has had occasion to give particular attention to the questions involved, in connection with the Spectatorium case, in the prosecution of which he took a prominent part.

Accountants frequently hear some very strange arguments against the value of their services. Not long ago, a piano man said that the numerals now in use were the same that had been employed for two thousand years, that accounts were but combinations of these numerals and that as there had been no improvement in the numerals there could be none in the combinations made of them, therefore the office system that had sufficed himself and his father for thirty years was incapable of improvement.

It would be a waste of time to tell such a man that the musical scale was the same to-day that it was when Nero fiddled while Rome was burning, that the same wire would give out the same note under the same conditions, therefore that the grand piano of to-day was no improvement on Apollo's lyre. Before ignorance so dense, we can simply stand in wonder, and rub our eyes to make sure that we are in progressive Chicago and not in mediæval Spain.

A well-known business man recently said: "That the improvement of existing methods and the introduction of new systems is work for which the professional accountant has fitted himself, and he is rapidly assuming the relation to office work that the architect bears to the erection of buildings. The ideal way of handling business records, so as to get the most satisfactory results, would be to have the accountant provide for each particular busi-

ness, diagrams and written instructions to correspond with the plans and specifications furnished by the architect."

This is all very well as far as it goes, but we beg to differ with him when he goes on to say that the office could then institute the system by following the instructions. It is doubtful whether any instructions could be written so fully and so plainly that there would be no need of the personal supervision of the trained accountant to see that they were properly carried out. The office would be apt to make a mistake similar to one made by an officer of the United States Army many years ago, in carrying out an architect's specifications.

In building a new post on the Pacific coast, before any competent carpenters had settled there, the government found it necessary to have the officers' houses made

in the East and shipped "knocked down" to the post. To prevent any possible chance of mistake every piece was numbered and explicit directions for putting them together accompanied them. The officer in charge of construction was very particular to see that each piece was properly laid next to the one with the corresponding number, and the houses went up with the greatest ease. Not until they were all entirely finished was it discovered that they were upside down, the parlor, diningroom and kitchen being on the second floor and all the bedrooms on the first, and in this shape they remain to this day.

Every accountant knows that if the ordinary bookkeeper is left to his own devices to install the most carefully devised system, the office is liable to find itself in an equally topsyturvy condition.



The Auditor

Illinois Society of Certified Public Accountants

Secretary's Office : 420 Calumet Building, Chicago

LIST OF MEMBERS

FELLOWS.	RELATION.	FIRM OR COMPANY.	LOCATION.
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Bentley, Arthur.....	Manager	Jones, Cæsar, Dickinson, Wilmot & Co.....	Chicago.
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Cant, Roddam.....	Accountant with....	Barrow, Wade, Guthrie & Co.....	Chicago.
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Ring, Richard F.....	In special practice..	Richard F. Ring.....	Louisville
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BUSINESS EDUCATION.

AN ADDRESS DELIVERED AT THE FIFTH ANNUAL BANQUET OF THE PENNSYLVANIA INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, IN PHILADELPHIA, APRIL, 28, 1905.

BY EDWARD S. MEADE, PH. D., SECRETARY OF THE EVENING SCHOOL OF ACCOUNTS AND FINANCE, UNIVERSITY OF PENNSYLVANIA.

Of all the problems now pressing for solution by American high schools and universities, the one most interesting to the community at large is the problem of business education. The necessity for elementary instruction in bookkeeping, office methods, commercial arithmetic, stenography and typewriting, as a preparation for any minor employment, has long been recognized in the business world; a fact attested by the extraordinary prosperity enjoyed for many years by that unique and most valuable institution, the business college. More recently the same work has been taken up by the high schools, and now there are few city high schools without commercial departments. The Young Men's Christian Association has taken up the same movement in evening classes, which have been largely attended, and, more recently, correspondence instruction has seized upon this promising field, and we have correspondence schools of advertising, salesmanship, bookkeeping and business practice. All the courses mentioned deal with what may be called the technique of business, the mechanical dexterity and the training in office routine which every employe must learn, and which, it is now universally recognized, can be taught to better advantage in the school than in the office. The methods of this instruction are well established and the results obtained are satisfactory.

But while the training of the subordinate in the school has been successful, the training of the superior in the university is still in the formative stage. The necessity for higher business education is conceded. During the past two years, out of perhaps fifty men of affairs with whom I have been privileged to discuss the subject, only a few—not more than two or three—have hesitated to admit the necessity of advanced instruction in business subjects. Business men have gone further than this. They have actively interested themselves in furthering the cause of business education. The most conspicuous example of these efforts is the American Institute of Bank Clerks, promoted and steadily supported by the leading bankers of the country, and now numbering several thousand members. The insurance companies have also entered the same field. The various associations of business men are emphasizing more and more the educational aspect of their activity, and in their papers and discussions treat of the involved and difficult problems which every business presents. The widespread interest in higher business education has forced its most definite expression in the larger universities. The universities of Pennsylvania, Michigan, Wisconsin, Illinois, California and Chicago, Leland Stanford University, New York University and Dartmouth College have established departments or schools of

business, described in their catalogues under the titles "Schools of Commerce and Finance," terms less vulgarly suggestive of the everyday world. The arrangement and content of the work offered by these institutions are generally similar. It is based upon the accepted proposition that certain knowledge and certain mental training are demanded for success in business, and that while this knowledge and training can be derived along narrow lines from the discipline of business experience, the efficiency of the business man will be enormously increased if, like the engineer, the architect and the lawyer, his experience can be preceded or accompanied by a course of study directed toward the scientific aspects of his practical interest.

The content of this necessary business training in the university has been apprehensively developed. It involves the study of geography; of the raw materials of industry, with the source of their supply and the methods of their production; of the institutions and agencies of finance, industry and trade; of the methods employed in the organization and management of the bank, the factory and the store; of the principles which underlie the financing of a business, the granting of credit, the sale of goods, the education of the consumer by means of advertising; of the principles of bookkeeping, the interpretation of the accounts of partnerships and corporations; the methods of cost-keeping; the relation of the business man to the transportation company; the principles of commercial law; of real estate values and management, and of insurance. Courses dealing with some or all of these subjects have been developed in leading American universities, and their popularity and value are attested by the large number of students who elect to pursue them.

The attitude of the business world toward university education for business is decidedly hesitating. While admitting the

necessity of business education, the average business man is prone to question the ability of the university to impart this instruction. His objections rest upon two grounds: First he questions the ability of men not engaged in business to teach business, and, second, when he contrasts the schools of business with the schools of law, medicine and engineering he is immediately struck by the fact that, whereas, in the professional schools the materials of the science and of the art can be brought together in the laboratory and in the library, in the business schools the materials for the study of business lie in the outside world and cannot apparently be assembled in a form for the student's use. These objections are forcible and fundamental. Unless they can be answered and unless their answer can be written in the teaching policy of American universities, higher education for business is unlikely to rise above the position which it now occupies—that of an annex to the regular college course.

Let us consider these questions in order. First, can a man who is not engaged in practical business give instruction in business subjects? I shall answer this question by asking another. Can a man who is engaged in practical business give instruction in business subjects? The business man's mind, from the beginning to the close of the day, and often far into the night, is occupied with the details of his own special interests. He has no time or leisure for the consideration of the problems, which, if he is successful, he instinctively solves. His whole time and strength are devoted to the hard task of making business success out of extremely refractory materials. Obviously, the business man, so long as he remains in business, is not available as a teacher. Physicians, lawyers and engineers are still to be found in our professional schools, and the instruction which they give is practical and valuable. But the life of the profes-

sional man is largely occupied in the discussion and consideration of the problems which must be presented before students, in which respect his daily life differs from that of the business man. The general unavailability of instruction of this character is shown in the tendency everywhere manifest in professional schools to displace men of active practice with teachers who give their whole time to the work.

Teaching is a profession which demands a major portion of the energies of those who engage in it. The teacher to be successful must assume a decided attitude toward his subject; he must look at the problems with which he deals in an impersonal way. His time must be devoted to the explanation of principles and the development of relations before his students, and this is difficult so long as his attention is constantly diverted from his classroom interests by the demands of his outside professional activity.

Granted, then, that business instruction, if given at all, must be given by business instructors, the question next arises: Does not this admission involve the abandonment of business education as a branch of professional instruction? From my own observation and experience I should answer most emphatically in the negative. The materials with which the business teacher must work are the recorded facts of business experience brought together in the reports of corporations, in the investigations of legislative committees, in the reports of government departments and in the voluminous trade literature. These materials can be mastered by the student and by the teacher, and they can be arranged in such a manner as to serve the purpose of classroom instruction. And although where the business teacher has had the benefit of business experience, his efficiency is greatly increased, business experience is by no means indispensable, and, indeed, it is quite impossible that the

teachers of business should be recruited on any large scale from the ranks of business men. The business teacher must come into frequent and even daily contact with the facts of business life. His acquaintance with business men must be large and must be unceasingly cultivated. He must familiarize himself with the latest happenings in the business world and must be a close and constant student of prices and markets. But just as some of the most successful teachers of law and medicine are men who have never practiced either of these professions, so it is reasonable to suppose that in the future the most successful teachers of business will be men who, while maintaining active contact with the world of affair, devote themselves exclusively to the work of writing and teaching.

Granting the practicability of higher business education from the standpoint of the teacher, what shall we say of the second objection which has been mentioned, viz., the difficulty of assembling materials for business instruction in such a form as to be available for the students? A professional education demands of the student not merely attendance at lectures and mastery of text books, but the working out of problems and cases and the investigation of questions involving the principles of the science which he is studying. The laboratory is assuming a steadily increasing importance in professional instruction, and the lectures are falling to a subordinate position. Is the laboratory method possible in the university school of business?

While I am able to answer this question in the affirmative, I am by no means certain that any university school of business in the United States has fully equipped such a laboratory. Instruction in these schools is as yet largely confined to the perusal of text books, to the extraction of statistics from government reports and to

the study of public economy instead of private business. The materials for students' investigation of business problems have not yet been assembled on a large scale. They exist and they are readily available. With the co-operation of the business man they can be placed at the disposal of the students. Examples of these materials are the records kept by wholesale houses and banks of large numbers of individual cases of business successes and failures. The reports of corporations furnish another valuable auxiliary.

The cost sheets of manufacturing and mining concerns should also be studied. There are thousands of cases reported in the State Law Reports which present materials for student investigation of business problems. To come more closely to your own interests, every accounting office in the United States contains reports of installations and audits which, by altering numbers, dates and places, could be made available for use in accounting teaching without violating professional confidence. I have indicated only a few of the sources from which the materials of a laboratory work in business can be derived. Every business establishment of long standing contains in its books of account and statistical records materials which would be invaluable if placed at the disposal of the teacher. That a large amount of this material has not been unearthed is not due to any unwillingness of its possessors to make it available, but to the fact that its importance has not been fully recognized and that no comprehensive effort has been made to secure it. When the teachers in our university schools can break away from their environment of academic routine and get into touch with those who are practicing what they profess to teach they will find the business man ready and anxious to help them by every aid which lies in his power to give. When they invoke the co-operation of the credit man,

the banker, the accountant and the manufacturer, business education will take on a true professional character and the schools of business will come to rank with the schools of law, medicine and engineering, producing efficient men and scientific books.

A further and most important contribution of the business man to the work of business education must be noticed. It will be instantly admitted by the most ardent advocates of business education, and it is taken as a matter of course by the man of affairs, that no matter how thorough may be the training given the student, he must serve an apprenticeship after leaving college in order to supplement his study of books by a study of men and things. Other professional schools claim to give this practical experience along with the regular course of study. The law student prepares briefs, the student of architecture designs buildings, the medical student rushes in where angels fear to tread. It may be questioned whether this experience has the value which is claimed for it, and whether the real benefit derived from a professional school does not consist in laying a foundation of facts and principles which must be supplemented after graduation by the experience of practice, before a high degree of efficiency can be achieved. However this may be with the school of medicine or law, the practice afforded by the school of business, even when it has availed itself of all the material available, falls far short of that given in the professional schools. The materials of business practice are not contained in a library, a hospital or a shop; they are found in the business world. The practice of business can only be thoroughly mastered in the transaction of business, and unless the student gains this experience during his college course he must expect to serve the regular apprenticeship after graduation.

But cannot this experience, at least in large measure, be gained during the four

years of college life? The student has a year of vacation time which he could be required to spend in some active employment as a requirement for his degree. So much at least could be done. And is it not possible to go further than this? Cannot arrangements be made with business concerns whose managers and owners are interested in furthering the cause of business education whereby, during at least a portion of his course, the student could devote half his day to some business employment, without pay, if necessary, in order to gain the practical experience without which he is useless? This employment should be varied; he should be moved about from one department to another and given opportunities to see the workings of every part of the business. As many enlightened employers have discovered in regard to their own employes, confinement to one routine is fatal to growth. Diversified employment, such as I have indicated, would be a most valuable supplement to the work of the university business school. The accountants who are especially interested in this subject of business education might take the lead in offering such facilities to the students who are specializing in their field. By so doing they cannot only render a valuable service to the cause of

professional education, but they can develop a corps of well-trained and most desirable assistants.

From the little study I have been able to make of this subject of business education, I am convinced that with the active co-operation of the business men whose interests it seeks to serve, it can be developed into a most important branch of professional training. My experience during the past year with the students of the Evening School of Accounts and Finance, nearly all of whom are men of considerable and varied experience in subordinate positions, has convinced me that even with the handicap of exhausting labor during the daytime, the work which they accomplish is fully equal to the average work of the day student in the business courses of universities with which I am familiar. This is in part, no doubt, due to their greater earnestness and maturity. In largest measure, however, it is, in my judgment, due to their familiarity with the concrete facts with which the study of business is concerned. When the regular university work in these branches is established upon a basis which combines practical experience with classroom instruction and laboratory investigation, the evolution of the professional business school will have been completed.

THAT INTEREST PROBLEM.

Mr. A. F. Rattray Greig, who furnished the problem in interest published in our June number, states that the answer should be the amounts which show the present worth at compound interest. Those who have so far answered it have assumed that the problem was one of simple interest.

Mr. Greig has given us the details of the computation, which are too long to publish here. His results show that the rate of discount is 6.2456 per cent and that

the present worth of each note would be as follows:

\$23,175	4 months	\$22,702.32
34,650	10 "	32,915.44
23,175	16 "	21,348.22
31,950	22 "	28,540.26
23,175	28 "	20,074.82
29,250	34 "	24,569.90
23,175	40 "	18,877.41
26,550	46 "	20,971.63

\$190,000.00

BUSINESS ORGANIZATION.

BY GERALD L. DE VOR.

The battle for commercial supremacy and the struggle for business existence in these days of close competition has forced upon the business world a keen appreciation of the absolute necessity of organization. Even where competition is not seriously intense, the business man often feels that he is not securing the best results from his system of management nor making the profits that the conditions of his business would justify him in expecting to realize.

The vital elements of an industrial enterprise are:

1. The application of energy along lines where the greatest results can be accomplished.

2. The elimination of all waste which interferes with such results.

It needs no argument to prove that organization is to be preferred to chaos and that system is far superior to a lack of it. Yet many firms do not fully realize how great might be the increase in the efficiency of their plant did they but possess a system of organization and management which tends to that ideal condition where every man, workman, foreman and superintendent is constantly working to the common end—"the good of the company." In the factory the best results cannot be obtained without organization. To discover all leaks in the course of manufacture and to indicate where the necessity for economies exists, system is absolutely necessary. It is now a recognized fact that very large economies can be effected by the introduction of rational and efficient factory systems which will properly care for the highly important details of factory work.

Under ordinary systems it is impossible for men to come in close contact with

all the amount of detail incident to any large business to enable them to possess that knowledge of factory efficiency which is so necessary to obtain the best results. In many cases the time of the manager and superintendent is so taken up with detail work in order to secure this result, that it prevents them from giving the proper attention to the larger and broader problems for which their education, experience and ability fit them.

For these reasons many firms which in their earlier days of small business were successful because of close personal supervision, have not made proportionate profits after they had grown to such size as to make it impossible for the head to retain that "personal touch" with the details, thus demonstrating the necessity for some plan or system to take the place of this "personal touch."

COST SYSTEM.

It is of primary importance to the manufacturer to know the accurate cost of every article that he sells. With the constantly varying elements in the cost of production, no manufacturer can feel sure of his ground without this knowledge. Numberless failures can be traced to an inefficient system of estimating or recording manufacturing costs, the manufacturer being unable to discover where he is losing money and consequently being unable to apply the remedy required.

The cost of producing the same article varies under different conditions. The elements which make up the prime cost and which are direct charges against the price of the article, are subject to a number of purchase price changes, while even more difficulty is caused and miscalculation results from defective estimate of the non-productive labor, the factory maintenance

and the selling expense. In but few cases do the results at the end of the year fulfil the expectations of the manufacturer who is guided in his selling solely by his estimates.

Whenever a manufacturer relies upon his estimates he is forced to depend in a great measure upon his personal knowledge of the conditions of manufacture, of the conditions of trade, and the cost of the elements in the cost of production and thus devotes much of his time to what should be mere clerical labor.

It is but another instance of high-priced men doing low-priced work, which illustrates the principles of economy in labor cost. The executive should devote his whole time to the thinking part, and the subordinate duties should be left to inexpensive help. It is no more fit that a business man should be his own cost clerk than that he should be his own book-keeper.

The manufacturer should be in a position to ascertain at any time the actual cost of production of any article manufactured, and should be able to check the cost of production of such article by a comparison with previous costs. It is the worst sort of business extravagance to estimate, even where such an estimate at the time is approximately correct, only to find at the end of the year that conditions had changed since the estimate was made and that contracts had been taken at a loss or goods ignorantly sold below cost.

Factory cost accounting should be devised in such a manner as to show not only the cost of the final product, but also to give unerring indications of the exact working conditions and efficiency of all departments. The cost of manufacturing each part should be accurately known and should be properly tabulated so that it may be compared with previous and subsequent costs for the same article. In this manner any variation in the cost of manu-

facture is immediately determined and any economies that may be necessary are at once brought to the attention of the manufacturer. Thus he is enabled to acquaint himself with all the details of the factory, to be fully conversant with the labor and material costs and to know from day to day the results and profits of his business. A cost system is an analysis of the transaction of a factory, by which the various kinds of costs are properly distributed down to the minutest detail. Thus it substitutes accurate results for estimates. It supplies the manufacturer with reliable information. The man with an efficient cost system is working in clear daylight, while the one with a defective system, or without any, is groping in the dark. And the advantage gained by the former is so great that it almost assures success from the outset.

STOCK SYSTEM.

The problem of stock is second only in importance to that of cost. It should be possible for a manufacturer to receive without delay at any time a report of the stock of raw material in part or gross, the material in process of manufacture and manufactured articles on hand, finished or part finished, without the tedious and costly process of taking inventory, and the method of obtaining this information should be so perfect that when the actual inventory is taken for verification it will prove up with the stock records. With a stock system a perpetual inventory may be had, the actual condition of the business kept under the eye of the administrative officers from day to day and periodical statements of profits prepared whenever desired.

The effect of a system for the care of stock is to insure economy in production, prevent unnecessary waste and furnish a check which will prevent any serious misappropriation. Each of these elements is a factor so important that the leakage re-

sulting in any one year where no efficient check has been provided may run into thousands of dollars.

Finally with an improved stock system there can at no time be an oversupply of stock on hand resulting in loss of interest on capital so tied up, nor on the other hand can there be a lack of stock which would result in buying under unfavorable conditions, or vexations and costly delays in the execution of orders.

OFFICE ACCOUNTING.

A good system of bookkeeping is of equal importance with a good system of costs. By adapting the books of accounts to the nature of the business and by suitable subdivisions thereof the work which under one system could hardly be done in the ordinary hours of business is under another and better one easily accomplished. The monthly totals from the cost and stock records are properly classified and made a part of the regular bookkeeping department. The actual purchases, sales and labor paid, together with the miscellaneous expenditures, would attest the correctness of the cost keeping and the stock records. This would all form a base for profit and loss, balance sheet and analytical statements which could be readily made up at the end of any one month.

Under an improved system much labor can be saved the accuracy of the work quickly tested, and trial balances prepared and errors located without a complete re-checking of the entire month's work.

AUDITING.

An independent audit embraces a verification of the accounts as shown by the balance sheet and an analysis thereof for the period under review. The value of such an audit by a professional accountant, both to officers and stockholders, is beyond dispute. His wide experience enables him to advise them on many knotty questions that may arise, such as analysis

of costs, reserves, depreciation and stock records, also the correction of all errors of principle.

In any case of purchase or sales, even where honesty is not questioned, the seller presents the best possible value of the assets and it is of course to the interest of the purchaser that the cold hard facts be known without any polish. It is equally to the interest of the seller that an accountant's name be attached to his statements.

The main feature of this investigation would be nature of assets and liabilities, profits earned and average profits, contracts, value of plant, fixtures, goodwill, etc., provision for bad or doubtful accounts, reserves, depreciation, charges to plant, etc.

THE EXPERT.

When the man who "plays a thinking part," whose activities are to a large degree administrative, learns that he cannot know everything that he needs to know about his own business without getting help from the outside specialist, he has mastered one of the biggest elements of success in modern business.

Every factory and office must be individually treated and a correct system is that system which is specially designed to meet the needs and requirements of each particular case; hence each case must be specially studied by the expert systematizer, and who but the specialist is best fitted for this work, as his mind is constantly employed in meeting and solving the most intricate problems in systematizing and costs.

The greatest economy in production is often reached by a liberal expenditure for brains. The cost of the introduction and carrying out of a proper system is inconsiderable in comparison with the results obtained therefrom. The fraction of a cent saved on each article manufactured very often means success and wealth.

THE ACCOUNTANT AS SECRETARY.

While the business world is rapidly becoming acquainted with the work done by the public accountant and is more and more recognizing the advantage of employing him, there is one way in which he is made useful in England, to which very little attention is paid in this country. It is a function that he is peculiarly adapted to exercise and in which he can be of special value to bankers and other business men who may be interested in companies outside of their regular business. It consists in doing the work for secretaries who have not the time to attend to the duties and yet wish to retain the office. It often happens that a banker would accept the position of secretary of some small company in which he is interested if he were able to give it the necessary time. He is willing to lend the influence and weight of his name and may be anxious to be an officer of the company so that he may be in touch with the active management, but he has not the time to give to the details of the office and he objects to having frequent calls made upon him during business hours at his office and to having his time taken up to the detriment of his regular work. To such a man the accountant offers his services, agreeing for a small monthly sum to attend to all the routine work that belongs to the secretary. He will make out the certificates of stock on presentation of a receipt from the treasurer, if an original issue, or of the old certificate, if a transfer and will send a messenger with the papers to the office of the secretary to obtain his signature, consuming only a moment of his time. He will keep the transfer record and post the shareholders' ledger, furnishing a typewritten alphabetical list of stock-

holders and their holding for the annual meeting. He will make up the secretary's reports to the directors or the stockholders and will send out notices of meetings to be held, or circular letters, or reports to the stockholders, and if desired, will attend these meetings and keep the records. The secretary not only rids himself of a large amount of work and worry, but he gains in having the work done by experienced persons who are not liable to make errors.

The same course can be pursued in case a busy man is made an executor, trustee or assignee. While retaining entire control over the funds and management of the estate, he can delegate the routine work to an accountant thoroughly posted in such matters, who has an office force capable of keeping the accounts, including the ordinary correspondence and answering nearly all the questions that can be asked, leaving to the principal only the most important points that he can settle in a few minutes, since all information in regard to them will have been prepared and submitted to him in concise form. By visiting the accountant's office at stated times he can arrange for interviews with important persons there, leaving the lesser ones to be attended to by the office force. In this way he will entirely avoid the necessity for interruption of his own affairs by calls upon him at his office and yet will feel that he is not neglecting the interests of the trust that he has undertaken. Were this course to be commonly pursued there would not be as much reluctance as now exists in accepting positions of trust, and many a competent man would be able to add something to his income who is now deterred from doing so because he has not the time to attend to anything more than he has already assumed.

SECRET RESERVES.

At the time of a large defalcation in one of the New York banks it was stated by the officers of the bank that the entire amount could be taken up without charging any of it to the undivided profit account. A great many persons were unable to understand how this could be done, and only a few were any wiser when told that the bank had a secret reserve.

It appears that the practice of accumulating secret reserves is a growing one, and that it is by no means confined to banks. It consists of an undervaluation of assets during prosperous years, the difference between the market price and the value carried on the books forming a fund which can be drawn on at any time, either by a sale of a portion of the securities or by an entry placing them on the books at a higher value, not greater than the market price.

The question of the advisability of such a proceedings has been hotly argued. Those who defend it seem to look upon the bank or company as an unchanging entity, claiming that it is better to conceal abnormal profits one year so as to provide against the necessity of showing unusual losses in another year. In the case of a close corporation whose stockholders know all about the company, there would be no serious objection, but there would also be no special reason for doing it. In the case of a company or bank, whose stock is somewhat scattered, and may be sold at any time on the basis of the published statements, it seems impossible to find any justification for the practice. The seller of such stock is unquestionably defrauded out of the increased price that he could have obtained for his stock if the true condition of the company had been known to him and the buyer.

To obtain a clearer idea of the justice

of such a practice it is necessary only to look at the true nature of a corporation. It is not probable that anyone would defend the managing partner of an ordinary copartnership if he deliberately understated the profits so as to prevent his partners from drawing out a greater dividend than he thought proper. But the president and directors of a corporation are simply the managers of a partnership affair, the act of incorporation being for the purpose of limiting the liability, and for greater convenience, but not in any other way causing the company to differ from an ordinary partnership.

The accountant who is acting for the stockholders of a company is not justified in signing a certificate to a statement which contains a secret reserve or any other element that is not exactly in accordance with the facts. Not only is he bound to tell the entire truth for truth's sake, but he is also under obligations to give all the stockholders all the information in his power. Those accountants who take a different view of this question defend their course on the ground that they are employed by the president and directors of the company, and are not supposed to criticise their management of the business. While it is true that it would be better to follow the English plan and have the auditors appointed by the stockholders as their special representatives, it does not seem clear that the appointment by the directors absolves the accountant from his duty to the stockholders. Although not made directly to them, his report is to be used with the stockholders, and should be as carefully prepared as if made originally to them, and should contain nothing which would cause any stockholder to make an incorrect deduction as to the true condition of the company.

LOGICAL MANUFACTURING ACCOUNTS.

A set of books is supposed to contain the history of the business to which they belong, and to exhibit its condition from time to time. As books are ordinarily kept, this is true only in a partial sense, applicable solely to the cash income and outgo. In other respects, the books are not a true history of the business and do not exhibit a true condition. This can be shown by an analysis of the trial balance of any manufacturing concern. Starting with the balance sheet at the beginning of the year, we have a true statement of assets and liabilities, but at the end of the first month we find an exhibit of balances that is totally incorrect. Raw material has been charged with all the goods bought during the month, and the account shows a large increase over the original inventory, the whole account being carried as an asset. Labor account is charged with all the pay-rolls paid during the month and also figures as an asset, or at least appears in the asset column. All the other expense accounts are treated in the same way, and we have from month to month a constantly increasing amount of debit balances, which do not in any way represent assets or anything else on hand. That these fictitious debit balances are offset by an equally fictitious credit balance in the sales account does not serve to make things any clearer, but rather adds to the confusion. This is what may be called the illogical method of treating the accounts.

The logical method requires that the books of account should be a history of actual transactions as they occur, and should show the true condition of affairs at all times and not at the end of the year only. Starting with the raw material, we have the original inventory which represents material actually in the storehouses. As new material is bought it is put into

the storehouse and is charged on the books. As the material is drawn out of the storehouse it goes into manufactured product on the books also, if the books are to be a true history of the business. Labor goes directly or indirectly into the product in the factory. There appears no reason why it should not follow the same course on the books in the office. All the outgo of the business is made for the sake of manufacturing or selling the product. None of it remains on hand from month to month, except the material and supplies, including in the latter unexpired insurance, advertising matter and similar items. The logical method requires that none of it should appear as a balance on the books except that actually on hand and that the latter balances should represent as nearly as possible the value at original prices of the material in the hands of the storekeeper, subject to verification and correction when the inventory is taken at the stated time.

Broadly stated, this is the logical idea, but it is capable of much more extended application by a subdivision of the product into classes, for each of which an accurate history is provided, showing the amount of material consumed and labor and expense incurred. All manufacturers attempt to reach this result, but they usually do it by a series of independent figures which do not enter into their books of account and are not made to balance to anything. While more or less accurate they cannot be depended upon, since there is no check on their truth as there would be in case they formed a part of the regular books and appeared on the trial balance.

It needs no argument to show that such a method of treating manufacturing accounts would be much more valuable than the crude method now generally in use.

Being a true history of all transactions, it would show the actual amount of material, labor and expense that had gone into each species of the product, whether finished or unfinished, and the amount of raw material or partially manufactured material that should be on hand. A manufacturer with such information at his command would have a much more intelligent idea of his business than he can now gain from figures which may or may not be correct, since they are at best only estimates or are based on past experience, the elements of which may have changed without his being conscious of it. In case the factory is destroyed by fire the advantage of exact information will be very manifest in the adjustment of the loss with the underwriters.

Modern methods have simplified the work necessary to obtain this exact information, so that it can frequently be arrived at with less expense of time and labor than is now involved in the prevalent crude and unsatisfactory methods. No universal system can be devised that will fit every manufacturing plant alike. Such a system is similar to the patent nostrum that is guaranteed to cure all diseases. Each plant requires careful study by a person who has made manufacturing accounts a specialty and can recommend such changes in the existing methods as the needs of the particular factory would indicate.

To the ordinary business man or manufacturer it seems impossible that any one person can assume the responsibility and keep in touch with the details of the enormous mass of transactions arising from the wonderful commercial developments of today. Unaided he would be unable to do so, and he therefore calls to his assistance the trained accountant whose years of

varied practice and continuous study of every species of business problems fit him to give the manufacturer the benefit of a highly developed analytical mind and a knowledge of general principles by which he can institute proper methods of analyzing and dealing with any of the details of the business and of tabulating them in such a manner that intelligent and valuable information is easily and concisely arrived at. The responsible head of the concern is thus in constant possession of exact information available not only for his own guidance, but for placing the facts before his directors or stockholders at any time desired, without the necessity of waiting until the end of the year.

This intimate and exact knowledge of the conditions of the business enables him to increase his profits by taking advantage of the markets, both as regards the purchase of materials and also the management of his sales.

The progressive and successful manufacturer realizes and takes advantage of the valuable knowledge that the practical and skilled accountant has to give to him. He knows that the experience of the accountant has been much more varied than his own has been, and that in meeting and solving difficult problems in the work to which he has devoted his best energies, he has absorbed and retained many points that would be likely to escape his own observation, and that he is therefore enabled to decide logically and without prejudice as to the best course to pursue and the best methods to use in arranging accounts to secure accurate and progressive analysis, to supervise and, when needed, to tabulate results for the information of his client.

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Articles appearing in **THE AUDITOR** are not to be read as having received the endorsement of the society, but are to be taken as individual expressions of opinion, and as such may be answered in future issues. The Editor invites contributions from all Accountants.

ANNOUNCEMENT

With this number of "The Auditor" we take pleasure in advising our friends and subscribers that we have arranged to issue our paper in the future under the name of "The Journal of Accountancy," with offices at 32 Waverly place, New York, and with such material enlargement, both of form and space, as will enable us to cover the broadening field of the public accountant's work more fully than we have found it possible to do under present conditions.

The Journal will be a monthly magazine of some eighty pages of reading matter and twenty pages of select advertisements. The first number will be issued about October 31, and subscribers to "The Auditor" will be supplied with the paper in its new form for such a period as their present unexpired subscriptions may entitle them. The price of the Auditor having been \$1 a year, and the price of the Journal of Accountancy being fixed at \$3, it is purposed to apply all subscriptions now open on "The Auditor's books pro rata

upon the new journal. Our subscription lists have been transferred to the New York office, 32 Waverly place, and it is requested that communications relating to them be made direct to the business manager of the Journal of Accountancy, who will be prepared to supply the magazine in its enlarged form.

"The Auditor" made its first appearance in September, 1904, as the organ of the Illinois Society of Certified Public Accountants, and for a few months continued in that modest capacity. In January, 1905, "The Auditor" changed its form and became more representative of the accounting profession in general than of the Illinois society in particular, though the latter organization continued to control its publication. After the appearance of this number the control of "The Auditor" passes to the Accountancy Publishing Company, a corporation formed by accountants of the whole country for the purpose of publishing a journal representative of the profession.

The improvements to be made in the journal are important and will result in the production of an organ in which every accountant may feel pride. It will be edited by eminent educators and managed by men experienced in the publishing business.

The Illinois society contemplates the change much as a parent does the maturity of a child. "The Auditor" has had its shortcomings and has lacked much of being all that we wanted it to be, but it has been of some benefit to the profession; and when it is remembered that the time necessary to attend to its affairs has been snatched from the few available moments of an exceptionally busy number of men, we feel that it has been distinctly creditable.

We thank our friends for their support and trust that the new journal may receive, as we know it will deserve, a full and generous continuance thereof.

Because commercial law is one of the subjects in which the applicant for the C. P. A. degree is examined, it might be inferred that it was intended that the accountant should take the place of the attorney with his clients and furnish advice on all legal points connected with the carrying on of his business. Accountants themselves know that this is a misconception of the case, for they are well aware that it is not possible for the ordinary man to be a first-class accountant and at the same time to rank as a high-grade lawyer, and, if it were possible, it is by no means desirable. The accountant must know the fundamental principles of the law and their applications to the ordinary affairs of business, especially as regards copartnerships and corporations, but that knowledge is little, if any, greater than should be possessed by the bank cashier or the officer of an incorporated company. When the accountant presumes to give advice on intricate questions of law he is going outside of his province and is trespassing on the territory of his brother professional, the attorney. To such an extent is this recognized by the accounting profession that there was serious, and to our minds valid, objection raised to a question that was included in the first examination of applicants for the degree of Certified Public Accountant in this state. "What class of property are the engine and cars of a railroad corporation? Are they subject to execution and sale for debt?" In our opinion the proper answer to that question on the part of the accountant would be: "That is not an accounting, but a legal, question; consult your attorney."

The accountant should know enough of commercial law to enable him to open the books and carry on the routine work of a business in such a way as to conserve and protect the interests of all concerned. He must therefore be able to point out the difference between a corporation and a part-

nership and the radically different position that an officer holds in a company from that of a partner in a firm, as these are matters of routine and the everyday conduct of the business. But he is not expected to give advice on matters that are beyond this and which require the attention of the trained legal mind.

While this is the attitude of the professional accountant toward the legal profession, we are sorry to say that the attorney is not always so careful not to trespass on the domain of the accountant. A few attorneys have had a business training and are therefore able to handle satisfactorily a case that involves ordinary questions of bookkeeping, and a few recognize their total ignorance of accounts and therefore rely on the accountant, but there are only a few who realize that an accountant is not a mere bookkeeper, and that they can use his services to advantage in all cases involving intricate accounts. They do not realize that the accountant is the scientific man of the business world, who is not content with merely finding out that an account or a set of books is properly balanced, but who is trained to analyze the figures that are put in his hands and to ascertain the ultimate truth that they hold.

The attorney would frequently have greater success with commercial cases if he would allow an accountant to collate the facts, as shown not only by the books, but by the other written documents in the case, and to make out from them a statement of the actual conditions. His conclusions are formed without regard to their bearing on his client's interests, but with a view simply to bring out the truth. The attorney takes the report thus made to him and from it he makes up the case for his client by applying his knowledge of the law. He is then able to go before a court with the certainty that his case is as well prepared as it is possible to be, depending only on the ability of the particu-

lar accountant to make the proper report and his own ability to apply to the case the principles of the law. During the conduct of the case the accountant can be of great service by his hints as to the kind of questions best adapted to bring out the strong points of the case, leaving to the attorney the duty of properly presenting them. As the accountant is accustomed to looking at conditions with an impartial eye, he is able to see the points that make against his client as well as those in his favor, and is, therefore, in a position to warn the attorney of the possibility of attack from those quarters in time for him to guard against them.

In discussing a business case with a client the attorney is frequently unable to grasp its salient features on account of the illogical way the client states it. The accountant, being a business man himself, can better understand the business man, and can then reduce his statements to a logical and consistent exhibit, which the attorney can easily comprehend. In one case that came under our observation one of the most eminent practitioners at the Chicago bar was to represent the prosecution in court. The other attorneys and some of the witnesses met him to give him the leading points in the case and talked for an hour, with the result of completely confusing him as to the facts relied on for success. The accountant who was present, took a single sheet of paper, wrote down a few concise sentences in logical order and handed it to him. After reading it he exclaimed, "Now I have the entire case. If we can prove these facts we will win." It was an instance of the advantage possessed by the mind trained to close and logical reasoning upon commercial subjects over the mind whose training was along other lines.

The certified public accountant does not try to enter the field of the attorney, and

he asks in return that the attorney shall recognize the peculiar fitness of the accountant to care for matters that properly lie in his field.

The locating of factories in towns anxious to increase in population and importance has become so large a business that the principal railroads have appointed industrial commissioners whose duty it is to introduce to the town the factories desiring to better their surroundings. Although these commissioners are usually men of high character and ability, they are not able to properly investigate the factories that they thus introduce, as the time at their disposal admits of only the most cursory examination of the facts submitted to them. They are obliged to leave to the towns themselves the more thorough verification of the statements made out by the applicants for concessions.

As the local banker is usually one of the most prominent of the members of the Business Men's Association, and as he is at least as much interested as anyone in seeing that none but worthy applicants are favored, it is important that he should be fully advised of the best methods of ascertaining the truth in regard to the enterprises to which he and his friends are requested to pin their faith and their money. The sources of information open to them are three in number.

First, there is the statement prepared by the applicant company itself. Leaving out the question of deliberate attempts to defraud, and treating only of the statements prepared by honest officers, it is found that they are seldom to be relied upon. There is too strong a temptation to the officers who have been managing a company to show good results and too great a tendency to look upon the future with hopeful eyes as they figure out the large gains to be made by the contemplated removal

to a new location to make us feel that their statements are not colored by the wish that is father to the thought. Even in the cases where due allowance is made for this tendency there is the further objection that the statements may be made by those who are not able rightly to classify the accounts and properly discriminate between accidental and legitimate profits, between investment and operating expense.

Secondly, there is the bookkeeper or business man of the town who is sent to look over the factory and report on the correctness of the statement submitted by it. Unless he is a trained man of large experience he is too apt to conclude that because the books are in balance and seem to be honestly kept, the profits shown at the end of each year are actual and arise from the regular operations of the business. Even if he has the time, he usually has not the experience necessary to enable him to analyze the plant and machinery accounts, to find omitted liabilities items of expense that are charged to investment and many other insidious faults that will materially reduce the alluring profits shown by the over confident secretary of the company.

Lastly, the certified public accountant. Who is he and what does he do? It is a mistake to consider him simply as an "expert" who can perform a mathematical feat with lightning rapidity. He must primarily be a man of large business experience who takes a broad view of the problems submitted to him, who is thoroughly posted in regard to all the details of operating in all lines of business, able to discriminate between what is a legitimate and what an accidental or sporadic profit, between what is properly an investment of capital and what an expense of the business, who will not allow hidden or suppressed liabilities to escape him, and who is, above all, independent and unbiased,

with no thought but the desire to discover the exact truth and to report it regardless of whom it helps or hurts. The factory whose history can stand the scrutiny of such a man can safely be relied on to prove a desirable acquisition to any town. His unfavorable report would have saved many a city from entertaining the cripples whose empty buildings are now an ugly blot on the landscape.

In these days of hurry and bustle we are apt to overlook the advantage of careful training and scientific attainment. As soon as a bookkeeper is able to add up a column of figures with reasonable accuracy and rapidity, and can take off his trial balance correctly once in three or four times, he poses as an expert accountant, although he may not know the first principles of accounts as a science. In the same way, a man who has served in all positions in a bank, from messenger to paying teller considers himself a thorough banker, capable of filling the position of cashier, although he may not be possessed of the first rudiments of the science of banking. For there is such a thing as the science of banking, if by science we mean the knowledge of general laws and principles and their application to particular instances. Without going into the subject of the laws which govern the movements of money in the whole country, or the larger subject of the nature of money and the proper standards of value, which really constitute the science of finance, let us see whether there are not general laws which govern the movements which take place in a single bank, laws which should be known to its officers and by which their actions should be governed. If there are such laws the active officers of the bank should study them and be ready to apply them to the individual instances that come under their observation. We venture the assertion that there are such

laws and that a cashier who has familiarized himself with them will be able to learn more from their application than in any other way, especially in regard to the kind of business that his customers are doing. A proper reading of a depositor's account will furnish more information than can be obtained from any other source, except an analysis of a trained accountant.

One of the most important of these laws can be stated thus: "The total deposits, including discounts of trade paper, of a commercial house cannot greatly exceed its total sales from year to year." To show that this must be so, it is only necessary to consider that there is no source from which it can receive an income except by the sale of its goods. There may be a slight excess, owing to the renewal in whole or in part of notes or acceptances given to it by slow customers, but the general principle holds good. Its application will prove the existence, where it occurs, of that most insidious foe to the banker, the use of accommodation drafts and acceptances. Kiting by exchanging checks is a comparatively easy thing to discover, but kiting by the use of time drafts on out-of-town customers or agents is extremely difficult to prove. In one case that came under the observation of the writer the depositor had been often accused of drawing accommodation time drafts on parties in other cities, but had strenuously denied it. When finally asked to explain why his total bank movement during the year amounted to more than twice his total claimed sales he was obliged to confess that the excess was fraudulent. It is needless to say that he was requested to close his account at the earliest possible moment.

Another important law is that "no one can legitimately draw a draft on another unless he has sold something to that other." The thing sold may not always be merchandise. It may be services, as in the

case of a traveling man drawing on his house for expense money. The application of this law once stopped a very peculiar triangular kite between Chicago and Denver. The parties were all dealers in books. A in Chicago drew at ten days' sight on B in Denver, asserting most positively that it was for books sold to B. As the drafts became more frequent, questions were asked of its Denver correspondent by the Chicago bank, who became convinced that B was not doing a business sufficiently large to justify such heavy payments. The Denver bank ascertained that B in Denver always drew a sight draft on C in Chicago on the day when his acceptance of A's draft matured. The bank in which B kept his account was then asked what goods B was selling to C, as it seemed impossible that he could be shipping books from Denver to Chicago. When it reported that he sold none, it was asked how B could draw a draft on C unless he sold him goods. The bank said it never had thought of that, but it began to think to such good effect that it closed up B, putting an end to the chain. As A had been in the habit of giving C currency to pay B's drafts the kite had been a very hard one to locate, but the discovery took place in the end.

These are samples of the way in which general principles can be applied to the particular instances that come into every banker's experience. The difficulty with many cashiers, as with the majority of people in all lines of business, is that they have never learned to give proper attention to the relation existing between actions or conditions which are apparently independent of each other, but which are quite intimately connected. All science is founded on a proper understanding of relations, and the science of the bank ledger does not differ in principle from those of a more abstruse character.

Accountants frequently find that employers are loath to adopt the plan of periodic audits for fear of offending their bookkeepers or cashiers. They will sometimes request that a secret examination be made at night without leaving any traces on the books. It is often difficult to show them that the more manly and, at the same time, more satisfactory way is to be frank with their employes, without acting in such a suspicious manner as to be offensive. All such ideas are based on the supposition that the auditor is antagonistic to the bookkeeper, and that his sole object is to act as spy upon him, seizing every opportunity to report the smallest clerical error as the next thing to a crime.

The truth is that the proper auditor is the bookkeeper's best friend. He is always ready to give him the advantage of a large acquaintance with accounts, so as to shorten processes and save labor, and will explain puzzling entries by giving the reason for them, so that they can be intelligently made. He will suggest improvements in methods of checking the work and finding errors, and will cheerfully answer any questions relating, not only to any particular set of books, but in regard to the science of accounts generally. In other words, he is an educator, both by precept and example and it will be found universally true that the man whose accounts are audited by a first-class accountant is a more competent office man than the one who has not had such opportunities. An instance of this occurred not long ago, when a young man asked the auditor why a certain entry was made in the way it was. The auditor, after explaining the reason, asked him whether he had not learned how to make such an entry at the business college of which he was a graduate. He said he had learned how to make it, but when he asked the professor the reason for it, he was told that the entry was made that way because it

was the proper way to make it. Unless the bookkeeper is one of those who "know it all," he will find many occasions when he can gain valuable information from the auditor at his periodical visits.

Such being the case, unless he is imbued with the false notion that the audit is a reflection on him, personally, he will welcome the auditor. As a test of his honesty and efficiency the audit is of even more service to him than to his employer. He knows himself that his accounts are correct, his employer only trusts so, but after the audit is made he knows what his employer knows also, and the positive knowledge is far more satisfactory than any confidence based only upon supposition. It is of value by confirming the trust placed in the bookkeeper to such an extent that if any unfortunate misunderstanding should arise, there will be no suspicion of his integrity, such as might happen if it had not been repeatedly proven by successive tests. If the bookkeeper looks upon the matter in the right way he will see that the request for an audit is a reasonable one. The proprietor of a business has a right to know that it is properly conducted in all its departments, and since he has either not the time or the ability to investigate the office for himself he does right to employ a disinterested outsider to do it for him.

The periodical audit is a great protection to the bookkeeper against himself. The temptation comes to all men at some time or another to do things that are not entirely defensible. It may be to temporarily force a balance, with the expectation of correcting it at a more convenient time. No man can be certain how completely he may be able to resist temptation. He will be obliged to do so, if he knows that within a definite time his error will be discovered. Better than the prayer, "Lead us not into temptation," is the precaution that makes it impossible to yield to it.

One of the most important services rendered by the auditor to the bookkeeper is in his requirements that there shall be a satisfactory voucher for every item of disbursement, and a full explanation of all entries. Many a man has been seriously compromised by falling into the loose habit of giving his employer larger or smaller sums of money out of the cash drawer without written acknowledgment. The employe is often unable to demand a voucher, but the accountant will insist on it and will not be content until the loose system is changed. In the same way he will require documentary authority for all

entries out of the ordinary, relieving the bookkeeper from the embarrassment of making entries, the correctness of which he questions, although he has hitherto been obliged to make them by instructions that were verbal only, and which could be conveniently forgotten by his employer if trouble arose afterward.

Let the bookkeeper then not only welcome the audit, but demand it in his own interest, making it a condition when he accepts a new position. The sense of security it will give him will amply repay him for any trouble that the periodic visit of the auditor will cause him.

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FELLOWS.	RELATION.	FIRM OR COMPANY.	LOCATION.
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Bentley, Arthur.....	Manager	Jones, Cæsar, Dickinson, Wilmot & Co....	Chicago.
Boughey, Frank M.....	In special practice...	Frank M. Boughey.....	Chicago.
Buchanan, Robert S.....	Individual practice...	R. S. Buchanan.....	Chicago.
Cant, Roddam.....	Accountant with....	Barrow, Wade, Guthrie & Co.....	Chicago.
Cooper, John Alex.....	Individual practice...	John Alex. Cooper.....	Chicago.
Dickinson, A. Lowes.....	Partner	Jones, Cæsar, Dickinson, Wilmot & Co....	New York.
Dunning, A. W.....	Western manager...	The Audit Company of New York.....	Chicago.
Fraser, Edward.....	Accountant with....	The Audit Company of New York.....	New York.
Gore, Edward E.....	Assistant manager...	Barrow, Wade, Guthrie & Co.....	Chicago.
Greig, A. F. Rattray.....	Individual practice...	A. F. Rattray Greig.....	Chicago.
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Jones, D. O.....	Accountant with....	Barrow, Wade, Guthrie & Co.....	Chicago.
Jones, Laurence A.....	Partner	Laurence A. Jones & Co.....	Chicago.
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Knisely, C. W.....	Manager	The Audit Company of Illinois.....	Chicago.
Kuhns, M. S.....	Secretary	Safeguard Account Co.....	Chicago.
Leith, John.....	Individual practice...	John Leith	Chicago.
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Pickett, L. S.....	Accountant with....	Barrow, Wade, Guthrie & Co.....	Chicago.
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Ring, Richard F.....	In special practice...	Richard F. Ring.....	Louisville.
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Stallings, A. J.....	Accountant with....	Barrow, Wade, Guthrie & Co.....	Chicago.
Stanley, Edward.....	Manager	Jones, Cæsar, Dickinson, Wilmot & Co....	Pittsburg.
Turville, Geo. A.....	Accountant with....	Jones, Cæsar, Dickinson, Wilmot & Co....	Chicago.
Walton, Seymour.....	Partner	Walton, Roberts & Co.....	Chicago.
Webster, George R.....	Manager	Jones, Cæsar, Dickinson, Wilmot & Co....	San Francisco.
Wilkinson, George.....	Partner	Wilkinson, Reckitt, Williams & Co.....	New York.
Wilmot, H. W.....	Partner	Jones, Cæsar, Dickinson, Wilmot & Co....	New York.
Young, Arthur.....	Partner	Stuart & Young.....	Chicago.
Associates—			
Brown, John H.....	Accountant with....	John Alex. Cooper.....	Chicago.
Laurie, John.....	Accountant with....	Jones, Cæsar, Dickinson, Wilmot & Co....	New York.
Millard, Henry.....	Individual practice...	Henry Millard	Chicago.
Seatre, W. Ernest.....	Manager	Jones, Cæsar, Dickinson, Wilmot & Co....	New York.
Junior—			
Cullen, W. H.....	Assistant with.....	John Alex. Cooper.....	Chicago.



